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FINANCIAL HOLDINGS LIMITED

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2001 Annual Report

Contents

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2001 Annual Report

Five Year Financial Highlights

(in $ millions except share and per share data)

	2001	2000	1999	1998	1997
Revenue	6,125.7	6,188.5	5,788.5	3,574.3	2,088.3
Net earnings (loss)	(346.0)	137.4	124.2	387.5	232.5
Total assets	35,438.7	31,833.3	31,979.1	20,886.7	10,207.3
Common shareholders' equity	3,057.6	3,180.3	3,116.0	2,238.9*	1,395.7
Common shares outstanding – year-end *(millions)*	14.4	13.1	13.4	12.1*	11.1
Return on average equity	(11.9%)	4.1%	4.3%	20.1%	20.4%
Per share					
Net earnings (loss)	(28.04)	9.41	9.20	32.63	21.59
Common shareholders' equity	213.06	242.75	231.98	184.54	125.38
Market prices per share					
High	289.00	246.00	610.00	603.00	403.00
Low	160.00	146.75	180.00	253.00	285.00
Close	164.00	228.50	245.50	540.00	320.00

** not including share subscription receipts issued December 22, 1998 or their proceeds*

Corporate Profile

Fairfax Financial Holdings Limited is a financial services holding company whose corporate objective is to achieve a high rate of return on invested capital and build long term shareholder value. The company has been under present management since September 1985.

Insurance subsidiaries

Commonwealth Insurance, based in Vancouver, offers commercial property and oil, gas and petrochemicals insurance in Canada, the United States and internationally, and commercial casualty insurance in Canada. The company has been in business since 1947. In 2001, Commonwealth's net premiums written were $176.4 million. At year-end, the company had capital and surplus of $161.8 million and there were 142 employees.

Crum & Forster (C&F), based in Morristown, New Jersey, is a national commercial property and casualty insurance company in the United States writing a broad range of commercial coverages. Its subsidiary Seneca Insurance provides property and casualty insurance to small businesses and certain specialty coverages. The company has been in business since 1824. In 2001, C&F's net premiums written were US$518.7 million. At year-end, the company had capital and surplus of US$956.9 million and there were 1,171 employees.

Falcon Insurance, based in Hong Kong, writes property and casualty insurance to niche markets in Hong Kong. In 2001, Falcon's net premiums written were HK$90.7 million (approximately HK$5 = C$1). At year-end, the company had capital and surplus of HK$226.7 million and there were 142 employees (including 100 from recently acquired Winterthur (Asia)).

Federated Insurance, based in Winnipeg, markets a broad range of insurance products in Canada primarily for commercial customers. The company has been in business since 1920. In 2001, Federated's net premiums written were $76.3 million, consisting of $59.0 million of property and casualty business and $17.3 million of life and group health and disability products. At year-end, the company had capital and surplus of $46.4 million and there were 245 employees.

Lombard Insurance, based in Toronto, writes a complete range of commercial and personal insurance products in Canada. The company has been in business since 1904. In 2001, Lombard's net premiums written (including cessions to CRC (Bermuda)) were $547.1 million. At year-end, the company had capital and surplus of $162.9 million and there were 737 employees.

Markel Insurance, based in Toronto, is the leading trucking insurance company in Canada and has provided the Canadian trucking industry with a continuous market for this class of insurance since 1951. In 2001, Markel's net premiums written were $75.3 million. At year-end, the company had capital and surplus of $44.9 million and there were 146 employees.

Ranger Insurance, based in Houston, specializes in writing property and casualty insurance in the United States to niche markets (propane, agri-products, bail bonds and public entities) which require unique underwriting, claims and loss control expertise. The company has been

in business since 1923. In 2001, Ranger's net premiums written were US$72.4 million. At year-end, the company had capital and surplus of US$78.8 million and there were 161 employees.

TIG Specialty Insurance, based in Dallas, is licensed to write substantially all lines of property and casualty insurance in all states of the United States. The company has been in business since 1911. In 2001, TIG's net premiums written were US$1,023.9 million. At year-end, the company had capital and surplus of US$1,148.4 million and there were 698 employees.

OdysseyRe reinsurance group

OdysseyRe, based in Stamford, Connecticut, underwrites treaty and facultative reinsurance as well as certain insurance business, with branches in London, Paris, Singapore and Toronto and affiliated offices in New York, Miami, Mexico City, Santiago, Cologne, Stockholm and Tokyo. In 2001, OdysseyRe's net premiums written were US$959.6 million. At year-end, the company had capital and surplus of US$872.2 million and there were 362 employees.

Other reinsurance subsidiaries

Compagnie Transcontinentale de Réassurance (CTR), based in Paris, writes life reinsurance internationally. In 2001, CTR's net premiums written were US$46.7 million, of which US$19.2 million related to life insurance. At year-end, the company had capital and surplus of US$85.5 million and there were 85 employees.

CRC (Bermuda) Reinsurance, based in Bermuda, continues to be a major reinsurer of Lombard Insurance. At year-end, the company had capital and surplus of $154.4 million.

ORC Re, based in Dublin, was established in 1997. It writes selected long term property and casualty reinsurance and fully reinsures the reinsurance portfolios of Fairfax's international runoff operations to provide consolidated investment and liquidity management services, with the RiverStone Group retaining full responsibility for all other aspects of the runoff. At year-end, the company had capital and surplus of US$1,955.1 million and there were seven employees.

Wentworth Insurance, based in Barbados, was incorporated in 1990. It writes selected long term property and casualty reinsurance. At year-end, the company had capital and surplus of US$54.8 million and there were seven employees.

Runoff subsidiaries

The Resolution Group (TRG) was formed in 1993 to manage the runoff of International Insurance Company and other discontinued lines of business written by the former Talegen group of insurance companies. The runoff required effective management of major direct excess and surplus lines insurance and reinsurance liabilities, the resolution of complex litigation and the collection and management of reinsurance assets. At year-end, International Insurance had capital and surplus of US$320.3 million.

RiverStone Group (RiverStone), run by TRG management, was established following the acquisition of TRG, primarily to manage the runoff of certain Fairfax insurance subsidiaries and other discontinued lines of business written by other Fairfax companies. RiverStone manages the Sphere Drake and RiverStone Stockholm runoff operations.

Claims adjusting and insurance brokerage

Lindsey Morden Group is engaged in providing claims adjusting, appraisal and claims and risk management services to a wide variety of insurance companies and self-insured organizations in Canada, the United States, the United Kingdom, continental Europe, the Far East, Latin America and the Middle East. In 2001, revenue totalled $438.9 million (including $14.2 million from Fairfax group companies). The company was established in 1923, and at year-end the group had 3,837 employees located in 355 offices.

Hub International is an insurance brokerage company selling a broad range of commercial, personal and life insurance products. The company was established in 1998, and at year-end had 1,990 employees in 130 offices in Canada and the United States.

Investment management subsidiary

Hamblin Watsa Investment Counsel (HWIC) provides investment management to the insurance, reinsurance and runoff subsidiaries of Fairfax. HWIC was founded in 1984.

Note: All companies are wholly owned except OdysseyRe, a public company of which Fairfax owns 73.7%; TRG, a private company in which Fairfax owns an effective 27.5% economic (100% voting) interest; Lindsey Morden Group, a public company of which Fairfax owns 68.4% of the equity and 86.6% of the votes; and Hub International, a public company of which Fairfax owns 36.8%.

To Our Shareholders:

2001 was our worst year since we began 16 years ago. It was the first year that we lost money and the third consecutive year we did not achieve our objective of earning a return on equity in excess of 20%. We lost 11.9% on average shareholders' equity in 2001 (compared with a loss of 4.4% for the TSE 300). We had a loss of $346.0 million or $28.04 per share in 2001 compared to a profit of $137.4 million or $9.41 per share in 2000. For the first time ever, book value per share decreased, by 12.2% to $213.06 per share, while our share price dropped by 28% to $164.00 per share from $228.50 per share at year-end 2000. As you can see, on any measure, 2001 was our worst year ever. Our very poor results resulted in our stock continuing to sell below book value during 2001, making it almost two and a half years that Fairfax's stock price has been below book value.

As I write this letter to you, I must say that I am shocked at our atrocious results over the last three years and I sincerely apologize to you, our shareholders. As it is for myself and most of our Board members, Fairfax officers and Hamblin Watsa principals, for many of you your investment in our company constitutes a significant portion of your net worth, which makes these results more painful. As always, we have disclosed the past, studied it and learned from it, and we continue to be focused on performing for you as we have done prior to the past three years.

Our loss in 2001 emanated from the large losses we suffered in the third quarter of 2001 which prompted my letter of November 3, 2001 to you (reproduced in Appendix A) and also prompted us to have our first ever conference call to explain the losses and answer all your questions.

As the letter explains, our third quarter loss was a result of two negative surprises: World Trade Center losses and reserve deficiencies.

The reserve deficiencies at C&F and TIG were particularly embarrassing because we had recognized reserve deficiencies in 2000 and, in fact, had told you in last year's Annual Report that we did not expect this to be repeated in 2001. As our letter indicated, these deficiencies were an industry phenomenon (the U.S. industry reported in excess of US$8 billion in adverse reserve development in 2001) and our management teams had been running their companies for only two years. Against the backdrop of the worst insurance market in 30 years, it has taken longer for us to recognize and fix the problems of the past – much longer than we had expected when we purchased both these companies.

In last year's Annual Report and in our November 3, 2001 letter, we suggested to you that, over time, C&F and TIG would be seen to be good acquisitions. I have nothing more to add other than results will ultimately tell the story.

Last year, we told you that the headwinds that had buffeted the U.S. property and casualty industry for 12 years had changed and we listed the reasons why this up cycle may have some "shelf life". Since then, we have had the World Trade Center loss (the largest loss in the history of the U.S. property and casualty industry, estimated to be in the US$30 to US$50 billion range), 40 year lows in U.S. short term interest rates, declining U.S. and European stock

markets (European insurers/reinsurers have common stock holdings in excess of their capital) and asset problems like Enron, KMart, Global Crossing, etc. We think the combination of these factors will result in the industry requiring a minimum combined ratio of 100% to achieve a marginal single digit return on equity – not too dissimilar to the experience of the U.S. property and casualty industry in the 1960s or the Japanese property and casualty industry in the past ten years, both periods during which low interest rates resulted in returns on equity for industry participants of 5% to 9% even with combined ratios below 100%.

As mentioned in my November 3 letter to you, we are now in a hard market again – a market in which our product is not being given away but being priced to cover all costs and provide a fair return (in some cases, to pay back the losses of the past also). Insurance capacity is being severely limited, prices are going up dramatically and policy terms and conditions have tightened significantly. While these conditions have attracted new capital, our guess is that the factors mentioned earlier will result in the industry's favorable conditions continuing for some time.

For the past 16 years, we have carefully expanded through acquisitions, as the opportunity to grow internally was very limited. This has now changed. We expect to grow our insurance/reinsurance businesses significantly, and increase our retentions significantly, during this hard market (with the exception of TIG Insurance, which because of its MGA platform and our insistence on 100% combined ratios, together with A. M. Best's downgrade of its rating to BBB+, will likely have a decline in its premium base, particularly its MGA produced program business). In the section on insurance, we describe more fully what we have already achieved at our insurance and reinsurance companies.

A very significant positive we had in 2001 was the OdysseyRe IPO completed on June 14, 2001. With the major support of Rob Giammarco and his team at Banc of America, Dick Falconer at CIBC Wood Gundy and many other investment dealers, OdysseyRe was listed on the NYSE through the sale of 17.1 million shares at US$18 per share. After the offering, Fairfax held 48 million (74%) of OdysseyRe's common shares and a US$200 million OdysseyRe three-year term note (US$150 million of which has since been refinanced externally). Based on the IPO price of US$18 per share, the value of the 48 million common shares and the term note of OdysseyRe, together with our cash proceeds from the IPO, amounted to $2 billion (US$1.3 billion). This was very gratifying as it showed that OdysseyRe, which was formed through a merger of our interests in Skandia America Re, CTR and TIG Re, had now arrived. With US$1 billion in net premiums written and US$1 billion in total capital, we anticipate that OdysseyRe, under Andy Barnard's leadership, is poised to grow significantly while achieving our target 100% combined ratio.

Why did we take OdysseyRe public? The reasons, discussed at last year's annual meeting, were as follows:

1. The NYSE listing and SEC registration provided OdysseyRe with a profile and transparency that benefited its worldwide client base.

2. Ratings were expected to improve, and S&P did in fact upgrade OdysseyRe's ratings to A- after the IPO.

3. The IPO provided additional financial flexibility at the Fairfax level. It raised US$434 million in cash and notes for Fairfax (including TIG), and Fairfax's continuing investment in OdysseyRe's now publicly traded shares was worth US$864 million at the IPO price (we have stated clearly that we will not sell control of OdysseyRe).

Our expectations were more than realized by the IPO and while OdysseyRe's stock price is trading below its IPO price currently, Andy is focused on performing for his shareholders over the long term.

Our very positive experience with OdysseyRe has resulted in our decision to take C&F public (assuming markets are willing). The additional financial flexibility at Fairfax will, among other things, assist us in achieving our objective of maintaining at least $800 million in cash and marketable securities in the holding company (about five times our annual interest expense) until our consolidated combined ratio comes down below 105% and our earnings cover our annual interest expense by five times, which should permit our debt ratings, which were dropped below investment grade by S&P and others, to become investment grade again.

The past year has tested our small team at Fairfax, the Presidents who run our companies and our guiding principles like never before. We were battered from all sides and it seemed like nothing we did worked! However, our guiding principles (again included, as Appendix B), survived intact, as did our key management group, in good humor and very focused on getting back to delivering results for our shareholders. During the year, Jonathan Godown (with many years at A.M Best, S&P and Milliman & Robertson) and Jane Williamson (formerly a partner at PwC) joined Fairfax from the outside while Roland Jackson, who was CFO at OdysseyRe, moved over to Fairfax Inc. Charlie Troiano took Roland's position at OdysseyRe. Meanwhile, at Hamblin Watsa, my partner Roger Lace assumed the additional responsibilities of chief investment officer. Our team at Fairfax and Hamblin Watsa and our Presidents continue to be the major strength of our company.

Below we update (painfully!!) the table on intrinsic value and stock prices that we first presented two years ago.

	INTRINSIC VALUE		STOCK PRICE
	ROE %	% Change in Book Value* per Share	% Change in Stock Price
1986	25.4	+ 183	+292
1987	31.3	+ 41	– 3
1988	21.2	+ 22	+ 21
1989	20.3	+ 23	+ 25
1990	23.0	+ 39	– 41
1991	21.3	+ 24	+ 93
1992	7.7	+ 11	+ 18
1993	20.3	+ 48	+ 145
1994	12.1	+ 25	+ 9
1995	20.1	+ 22	+ 46
1996	21.4	+ 63	+ 196
1997	20.4	+ 44	+ 10
1998	20.1	+ 47	+ 69
1999	4.3	+ 26	– 55
2000	4.1	+ 5	– 7
2001	(11.9)	– 12	– 28
1985-2001	**16.3%**	**+ 34%**	**+ 28%**

** First measure of intrinsic value as discussed in our 1997 Annual Report*

2001 was all minuses! In fact, investments per share dropped by 5% after dropping 10% in 2000. While we definitely dropped intrinsic value last year, particularly at TIG, the long term value of the rest of our insurance and reinsurance businesses may well have increased because of the World Trade Center disaster. No substitute for profits though!! By the way, some of you think that our stock price is low because of a lack of liquidity – the table shows you it is because of a lack of performance!

As explained to you in our letter of November 3, 2001, the losses in the third quarter plus the opportunity that we saw in the P&C industry resulted in our issuing 1.25 million shares at $200 per share. This was the first time in our 16 years we sold stock below book value – and oddly enough, this sale was among the toughest to complete. Ten years ago, in 1991, we wrote to you that we would always sacrifice returns in order to maintain a strong financial position. Our stock issue in 2001 was a case in point.

The table below shows the sources of our net earnings with Lindsey Morden equity accounted. (This table, like various others below, sets out an analysis which we have consistently used and which we believe assists you to understand Fairfax, even though it may not follow GAAP: please see note (2) on page 47 in the MD&A. One of the objectives in our guiding principles is to provide complete disclosure annually to our shareholders, and we work hard to do this in a manner which best discloses the substance of our information, both good and bad.)

	2001	**2000**
	($ millions)	
Underwriting		
Insurance		
Canada	(119.5)	(13.0)
U.S.	(637.9)	(588.4)
Reinsurance	(214.7)	(97.4)
Interest and dividends	491.7	593.5
Operating income (loss)	(480.4)	(105.3)
Realized gains	213.5	378.3
Runoff	(27.4)	43.3
Claims adjusting (Fairfax portion)	(3.9)	(15.4)
Interest expense	(155.2)	(164.7)
Goodwill and other amortization	(7.0)	(5.4)
Negative goodwill	78.6	108.7
Swiss Re premium	(143.6)	(167.2)
Kingsmead losses	(116.7)	(33.0)
Restructuring	(49.1)	(16.4)
Corporate overhead and other	(38.9)	(35.5)
Pre-tax income (loss)	(730.1)	(12.6)
Less (add): taxes	(382.5)	(173.3)
Less (add): non-controlling interests	(1.6)	23.3
Net earnings (loss)	(346.0)	137.4

The table shows you the results from our insurance and reinsurance (underwriting and investments), runoff and non-insurance operations. Runoff operations include TRG, RiverStone Stockholm and Sphere Drake. Claims adjusting shows you our share of Lindsey Morden's after-tax income. Goodwill and other amortization includes amortization of Hamblin Watsa, Lombard, Ranger and Seneca. The corporate overhead expense is net of Hamblin Watsa's pre-tax income and interest income on Fairfax's cash balances. The premium payable to Swiss Re of $143.6 million is shown separately and discussed in the MD&A under Swiss Re premium on page 58. Also shown separately are realized gains so that you can better understand our earnings from our operating companies. Also, please note the unaudited financial statements of our combined insurance and reinsurance operations and of Fairfax with Lindsey Morden and TRG equity accounted, as well as Lindsey Morden's financial statements, shown on pages 94 to 99.

The principal components of the large loss in 2001 were:

(a) World Trade Center losses of $288.3 million (US$186.8 million), described in detail on page 50;

(b) the net cost of 2000 and prior years' reserve strengthening at TIG and C&F of $304 million (US$197 million), described in detail on page 50;

(c) Enron losses at OdysseyRe ($23 million), Kingsmead losses excluding World Trade Center losses ($54.3 million) and restructuring charges ($49.1 million); and

(d) underwriting losses, excluding World Trade Center losses and TIG and C&F's prior years' reserve strengthening, at TIG ($272.7 million) and C&F ($87.6 million) and in Canada ($80.2 million).

With some good fortune in 2002, (a), (b) and (c) should not be repeated and (d) should be significantly reduced. However, in the P&C insurance industry, as our long-suffering shareholders know, there are no guarantees.

Interest and dividends declined by $101.8 million in 2001 to $491.7 million because of increased interest expense on funds withheld payable to reinsurers of $43.9 million (please see Funds withheld payable to reinsurers on page 61) and a $0.8 billion lower average investment portfolio reflecting the payout of claims in the runoff operations and in the U.S. insurance companies, as well as a lower investment yield, as discussed on page 56. The funds withheld payable to reinsurers balance increased in 2001 because of stop loss reinsurance purchased for C&F and TIG for the years 1999 and 2000 and Fairfax's corporate insurance cover with Swiss Re.

In our 1999 Annual Report, we discussed Fairfax's purchase of a US$1 billion adverse loss development reinsurance cover (for 1998 and prior years' claims and unrecoverable reinsurance) from an AAA rated subsidiary of Swiss Re Group. In 2001, we ceded US$203.8 million to the cover for a cumulative total of US$727.4 million. The adverse development (before redundancies) arose mainly from C&F (US$62.4 million), Ranger (US$39.5 million) and our runoff subsidiaries (US$96.1 million). The cost of this cover in 2001 is the Swiss Re premium shown of $143.6 million (more on page 58).

We have a separate section in the MD&A on runoff (page 57), which shows you the components of the $27.4 million lost there. The loss on the Kingsmead syndicates, which we sold to Advent last year, is described further on page 59 in the MD&A.

The large underwriting losses, combined with reduced realized gains, resulted in a pre-tax loss of $730.1 million in 2001 – the third consecutive year we have had pre-tax losses. With the tax recovery of $382.5 million, we had a huge net loss of $346.0 million.

Insurance and Reinsurance Operations

The table below shows you the combined ratios of each of our companies for 2001 and 2000. Also shown is the "adjusted" combined ratio for 2001, which excludes the impact of catastrophe losses (World Trade Center, Enron and Tropical Storm Allison) and prior years' reserve strengthening for the U.S. insurance group. In the insurance business, there is always something exceptional taking place in any year – so take "adjusted" with a pinch of salt!!

While the group combined ratio at 121% was the second worst combined ratio we have ever had (140% in 1989 was the worst), the underlying operations in all our companies (with the exception of TIG) are all much improved. As mentioned in last year's Annual Report, there is no question that I was too optimistic when we purchased C&F and TIG about industry conditions in 1998 and 1999 and our ability to turn around these operations. Fully developed accident year combined ratios for 1999 for C&F and TIG are now running at 146% and 128% respectively versus our expectations of 110% and 105% at the time of purchase. Please read that sentence again because it is quite astounding how wrong one can be in this industry. Not that this helps but the whole industry, including the very best, had a similar experience!

	Underwriting profit (loss)	Combined ratio		
	2001	Adjusted 2001	2001	2000
	($ millions)	%	%	%
Commonwealth	(58.8)	122.6	162.6	105.5
Federated	(2.0)	102.8	102.8	106.5
Lombard	(76.4)	111.5	115.3	100.6
Markel	0.4	99.4	99.4	103.4
Total Canadian insurance(1)	*(119.5)*	*111.0*	*116.4*	*102.0*
C&F	(245.0)	109.0	131.1	124.3
Ranger	(81.7)	120.8	182.9	146.3
TIG	(456.8)	116.0	128.1	123.1
Falcon	(4.0)	125.2	125.2	173.4
Total U.S. insurance(1)	*(637.9)*	*113.7*	*125.3*	*124.3*
OdysseyRe(2)	*(214.7)*	*103.1*	115.4	108.0
Total	*(972.1)*	*110.4*	*120.7*	*116.3*

(1) After recoveries under the Swiss Re cover

(2) Including CTR in 2000

On pages 53 to 56 of the MD&A, we have provided more disclosure on each company's operations so that you can see how each of them individually has done. I will not repeat that disclosure other than to make the following points:

(a) Canadian insurance operations

We have excellent management running our Canadian companies and those managements have been in place for some time. However, excluding Markel, 2001 was a very poor year for them. With the exception of Markel, which continued to have excellent underwriting results, all of our Canadian insurance companies had combined ratios (even adjusted combined ratios!) in excess of 100%. On pages 53 and 54 of the MD&A, we discuss the reasons for their poor underwriting performance in 2001. In this hard market, with price increases in excess of 20% (depending on the line), we expect Ron Schwab (Commonwealth), John Paisley (Federated), Byron Messier (Lombard) and Mark Ram (Markel) all to achieve their target 100% combined

ratios (with expanding volume). Each of these companies has increased its retentions significantly.

(b) U.S. insurance operations

Because of the prior years' reserve increase at C&F and TIG, results in our U.S. operations were very painful. However, as discussed in last year's Annual Report, we feel the heavy lifting at C&F and Ranger is over and Bruce Esselborn (C&F) and Phil Broughton (Ranger) can focus on Fairfax's target 100% combined ratio. However, I am not going to predict our results – expect me to forecast 2002 results at the end of the year! Having said that, Doug Libby (Seneca) had another great year with a solid combined ratio of 98%.

TIG, however, continues to be a work in progress. Recently, Courtney Smith resigned and Jim Dowd took over as Interim CEO. We have three separate businesses in TIG. We had approximately US$69 million of net premiums written in 2001 in special risk operations (excess casualty, excess property and healthcare) headquartered in Napa and US$60 million in Hawaii (small commercial and personal lines). We are comfortable with our special risk business run by Steve Brett and our Hawaii business run by Wayne Hikida but, as mentioned earlier, the program business in Dallas (approximately US$895 of net premiums written in 2001) will shrink significantly. In the current environment, we expect our special risk operations to grow significantly.

(c) Reinsurance operations

Through Andy Barnard's excellent leadership, we now have a focused worldwide reinsurance company with one platform and capital base with approximately US$1 billion in net premiums written. OdysseyRe's combined ratio for 2001, excluding catastrophe losses (World Trade Center, Enron and Tropical Storm Allison), was 103%. In 2002, excluding a repeat of 2001's unusual events, OdysseyRe is set to make an underwriting profit and also expand significantly. For more details on OdysseyRe, please review its annual report, which is on its website (*www.odysseyre.com*).

Many of our long term investors look at our P&C operations and have tried to identify the float that we generate and the cost of that float. Warren Buffett and Berkshire Hathaway first provided a table disclosing this in their 1990 annual report. For the first time, here are our numbers.

Year	Underwriting profit (loss) *($ millions)*	Average float* *($ millions)*	Benefit (Cost) of float	Average long term Canada treasury bond yield
1986	3.5	29.8	11.6%	9.6%
1987	1.0	54.8	1.8%	10.0%
1988	0.4	72.1	0.5%	10.2%
1989	(13.3)	80.8	(16.5%)	9.9%
1990	(12.5)	137.1	(9.1%)	10.8%
1991	5.3	180.7	2.9%	9.7%
1992	(16.9)	183.6	(9.2%)	8.8%
1993	2.1	320.4	0.6%	7.8%
1994	(16.9)	683.6	(2.5%)	8.7%
1995	(40.9)	913.2	(4.5%)	8.3%
1996	(50.6)	1,423.1	(3.6%)	7.6%
1997	(56.2)	2,683.5	(2.1%)	6.5%
1998	(311.4)	5,303.3	(5.9%)	5.5%
1999	(617.1)	8,545.7	(7.2%)	5.7%
2000	(698.8)	7,905.5	(8.8%)	5.9%
2001	(972.1)	6,898.8	(14.1%)	5.8%
Weighted average			(7.9%)	6.1%

Fairfax weighted average financing differential: 1.8%

* *Excludes runoff operations*

In the table above, float is the sum of loss reserves, including loss adjustment expense reserves, and unearned premium reserves, less accounts receivable, reinsurance recoverables and deferred premium acquisition costs, for our insurance and reinsurance companies. This float is the amount of money we hold in our insurance and reinsurance operations because we receive premiums much before losses are paid. The cost of this float is the underwriting loss or the excess of losses and expenses over premiums. Of course, if we have an underwriting profit, our float has no cost. Insurance businesses are valuable if they generate increasing float at an acceptable cost. We have compared our cost of float to average long term Canada treasury bond yields (which generally are higher than comparable U.S. treasury bond yields).

From the table, the following observations can be made:

1. We have grown our float very significantly over the past 16 years even though in the past two years it has declined. This growth has been mainly through acquisitions. We expect growth in the next few years to be internally generated.

2. In only five of our 16 years has this float had no cost to us. In another five of those 16 years, the float cost us less than long Government of Canada bonds, i.e. we borrowed at rates less than the Government of Canada. In the remaining six years, our float cost more than long Government of Canada bonds – four of these years being the most recent four. In fact, in 2001, our cost of funds was over eight percentage points higher than long Government of Canada bonds – the highest differential in 16 years. Hopefully an anomaly!!

   On average, over 16 years, our float cost us about 180 basis points above the Government of Canada's borrowing cost in the long term market. Our objective, at a 100% combined ratio, is to have no cost for our float.

3. Finally, of course, the value of the float is not only its cost but also a function of how well it is invested. On that score, we have one of the best investment teams around with an excellent track record. Over time, this is a major positive and, as mentioned before, what attracted me to the business in the first place.

The table below shows you the breakdown of our year-end float for the past four years.

	Canadian Insurance	**U.S. Insurance**	**Reinsurance**	**Runoff**	**Total**
			($ millions)		
1998	784.3	4,171.3	3,195.8	–	8,151.4
1999	767.3	4,834.6	3,338.2	2,159.1	11,099.2
2000	814.0	3,417.2	2,639.7	1,443.9	8,314.8
2001	1,124.9	3,173.2	2,628.5	2,378.4	9,305.0

In 1999, the runoff segment was formed with the acquisition of TRG, as discussed under Runoff on page 57. The increase in the reinsurance segment in 1999 reflects the acquisition of TIG Re, offset by the transfer to runoff of Sphere Drake, ORC Re and RiverStone Stockholm, all of which were included in the reinsurance group at year-end 1998. The increase in the U.S. insurance segment in 1999 reflects the acquisition of TIG Insurance. The increase in the runoff segment in 2001 reflects the inclusion of CTR's non-life reinsurance portfolio effective January 1, 2001.

Except for acquisitions, the float generated in our U.S. and reinsurance operations has been flat to declining because we have not increased the amount of insurance/reinsurance business that we have written due to very soft markets. In the next three years, as long as current markets prevail, we expect the float generated in all our businesses, except TIG, to increase.

As you know, each year we emphasize to you the importance of proper reserving at our insurance and reinsurance companies. We have had external actuaries (two sets of external actuaries in some cases) reviewing our reserves since we began in 1985. In spite of this huge focus on reserving conservatively, in 2001 we experienced some very significant unforeseen prior years' adverse development in our U.S. insurance companies – some relating to periods before we acquired the companies and some relating to the transition period of our watch when new management significantly changed underwriting and claims handling practices and controls. As mentioned earlier in this report, our experience and that of others in the industry reflected the very poor pricing environment in the late 1990s. In the current vastly improved

pricing environment, we do not expect this experience to be repeated. In Canada in 2001, we had some unexpected development from the past, which we describe on page 65. We continue our strong focus on conservative reserving.

Claims Adjusting

2001 was a turnaround year for Linsdey Morden. As the table below shows, free cash flow (cash flow from operations less net capital expenditures), operating earnings and earnings before tax and goodwill showed vast improvement over last year.

Year ended December 31	**2001**	**2000**
	($ millions)	
Free cash flow	20.6	(7.7)
Operating earnings	12.7	1.6
Earnings before tax and goodwill	(0.8)	(27.1)

It was gratifying that each of the five operating units (Canada, U.S., U.K., Europe and International) contributed to the improved results through significant growth in revenue, cost containment and additional restructuring. Cunningham Linsdey UK had a particularly good year as it generated $25.1 million of free cash flow, more than fully justifying our purchase price of Ellis & Buckle in 1998 and our faith in the leadership of Gerry Loughney. Aggregate free cash flow at the other operating units was $12.7 million (thanks to Bill Hornick at Canadian operations, Farid Nagji at U.S. operations, Pim Polak Schoute and Gerard Böttcher at European operations and Jim Grant at International operations) while corporate and financing costs were $17.2 million.

As Interim CEO, Francis Chou was a tower of strength as he helped guide the turnaround and helped select Karen Murphy as the continuing CEO. Under Karen's disciplined and focused leadership, we expect continued good results in Linsdey Morden.

During the year, Ken Polley and Ferd Roibas retired as Chairman and President respectively and Jim Dowd was named the new Chairman of Lindsey Morden. For more details on Lindsey Morden, please review its annual report, which is on its website (*www.lindseymordengroupinc.com*).

Financial Position

As mentioned in previous Annual Reports, we feel our unaudited balance sheet with Lindsey Morden and TRG equity accounted (shown on page 96) is the best way to understand our financial position. Below, we show you our year-end financial position compared to the end of 2000.

	2001	**2000**
	($ millions)	
Cash and marketable securities	833.4	545.4
Long term debt	2,205.8	1,851.4
Net debt	1,372.4	1,306.0
Common shareholders' equity	3,057.6	3,180.3
Preferred securities	560.8	592.0
OdysseyRe non-controlling interest	361.8	–
Total equity	3,980.2	3,772.3
Net debt/equity	**34%**	**35%**
Net debt/total capital	**26%**	**26%**

Cash and marketable securities in the holding company increased significantly due to our $250 million stock issue plus the external refinancing of most of the OdysseyRe debt to Fairfax. Included also is OdysseyRe's minority interest which supports repayment of OdysseyRe's debt. In spite of the effect of the lower Canadian dollar, our net debt to equity and net debt to capital ratios were maintained during the year.

In the MD&A, we discuss our cash requirements during 2002 (page 86) and provide a line-by-line description of all major assets and liabilities on our balance sheet (beginning on page 60). In spite of the battering inflicted by our results in the last year (and in the two years before that), our balance sheet has retained its strength.

This demonstrates again the importance of a strong balance sheet and financial position. We are focused on maintaining this strength. Our financial position continues to be strong for the following reasons:

1. We have no bank debt. Our debt consists of seven public debentures with a long term to maturity (2 years to 36 years) and low interest rates (6.875% to 8.30%), two small debentures issued to vendors, OdysseyRe's debt created in connection with its IPO and certain debt assumed with the acquisition of TIG. All of the public debentures were issued under a single trust indenture containing no restrictive covenants, thus providing us with great flexibility. We have swapped the fixed interest rates on the five public debentures maturing after 2006 into floating rates (or as noted in the next sentence), saving approximately 153 basis points in 2001. We swapped US$125 million of our 7.375% debentures due April 15, 2018 for Japanese yen denominated debt of the same maturity with a fixed rate of 3.48% per annum (see note 5 to the consolidated financial statements). Including the amortization of the unrealized foreign exchange loss on this swap over the remaining term to maturity, the effective rate for 2001 was 4.375% per annum, still below the 7.375% coupon rate of the swapped debentures.

2. We have unsecured, committed, long term bank lines in excess of $900 million with excellent covenants. These bank lines are with five Canadian, five U.S. and two European banks. Please see the details on page 87 in the MD&A.

3. Our net long term debt is less than three times our normalized earnings base (you have yet to see it!!). Also, our earnings base is well diversified among many insurance and reinsurance companies and Lindsey Morden and geographically from Canadian, U.S. and international sources of income.

4. Available cash flow at the Fairfax (holding company) level from dividends, management fees and interest income should cover our administrative and interest expenses and preferred dividends by one to two times. This is based on normal dividend payouts from our insurance companies, which are less than our maximum dividend-paying capacity. In 2001, we took substantially less than our normal dividend payouts. In 2002, our maximum dividend capacity is $232 million compared with $343 million in 2001 reflecting the poor operating results in 2001, particularly at the U.S. insurance companies. Note Fairfax's combined holding company earnings statement on page 101.

5. With more than $800 million in cash and marketable securities in the holding company at year-end, we could pay our administrative and interest expenses and preferred dividends at Fairfax, with *no* dividends from any of our insurance or reinsurance companies, for three to four years – our management holding company survival ratio!

6. As discussed on page 85 in the MD&A, with the exception of TIG all our insurance and reinsurance companies are well capitalized with solvency margins well in excess of mandated regulatory levels.

7. Our foreign exchange exposure from our U.S. insurance and reinsurance companies has been fully hedged by our U.S. dollar debenture issues and the purchase of foreign exchange contracts. While hedged, the lower Canadian dollar could result in Fairfax using cash to roll over certain of the foreign exchange contracts referred to in notes 1 and 16 of the financial statements.

8. Importantly, the listing of OdysseyRe and (assuming markets are willing) C&F provide meaningful flexibility to Fairfax as cash could be generated by the sale of shares (not the control block).

Investments

Equity markets continued to decline in 2001 with the S&P500 down 13%, the NASDAQ down 21% and the TSE 300 down 14%. Long U.S. treasury yields dropped significantly from 5.46% at December 31, 2000 to 4.88% at October 31, 2001 but closed the year at 5.47%.

The unrealized gains (losses) as of year end are as follows:

	2001	2000
	($ millions)	
Bonds	(321.1)	(463.4)
Preferred stocks	(0.4)	(0.7)
Common stocks	39.9	(25.1)
Real estate	4.4	–
	(277.2)	(489.2)

Our unrealized bond loss of $463.4 million at the end of 2000 became an unrealized gain of approximately $250 million as of October 31, 2001, but because interest rates on long U.S. treasuries increased after that date, we ended the year with an unrealized bond loss of $321.1 million. Assuming corporate spreads remain at their year-end levels, our unrealized bond losses would disappear if interest rates decline by half a percentage point, and would become an unrealized gain in excess of $800 million if interest rates decline by one percentage point.

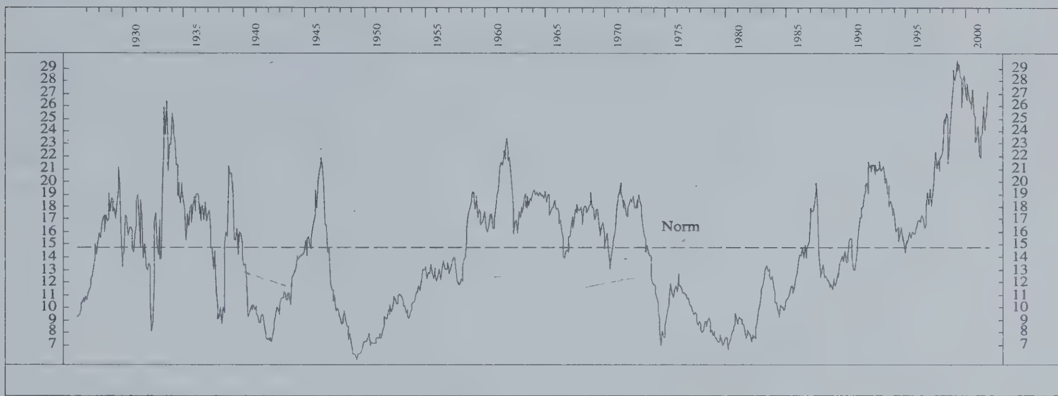
We realized $162.3 in gains in 2001 – about 40% of our gains in 2000. Given the size of the portfolio, we have done much better in the past. Net gains from bonds were $28.4 million. Gross realized gains on common stocks in 2001 totaled $186.7 million (excluding the OdysseyRe IPO gain of $51.2 million). After realized losses of $14.1 million, net realized gains were $172.6 million. The principal contributors to the stock realized gains were put contracts on a basket of technology stocks ($75.1 million), Rothmans ($35.0 million) and S&P500 Index puts ($11.4).

The technology bubble that we discussed in our 1999 and 2000 Annual Reports continued to deflate in 2001. Most of the "senior" and "junior" issues continued to fall in 2001. The S&P500 also declined but, as the table below shows, continues to sell at very high levels.

As of December 31	S&P500 Index	Earnings	Price/ Earnings	% Change in Index
1996	741	39	19x	
1997	970	40	24x	+31%
1998	1,229	38	32x	+27%
1999	1,469	49	30x	+20%
2000	1,320	54	24x	–10%
2001	1,148	26	44x	–13%
1996-2001		**–33%**	**+132%**	**+55%**

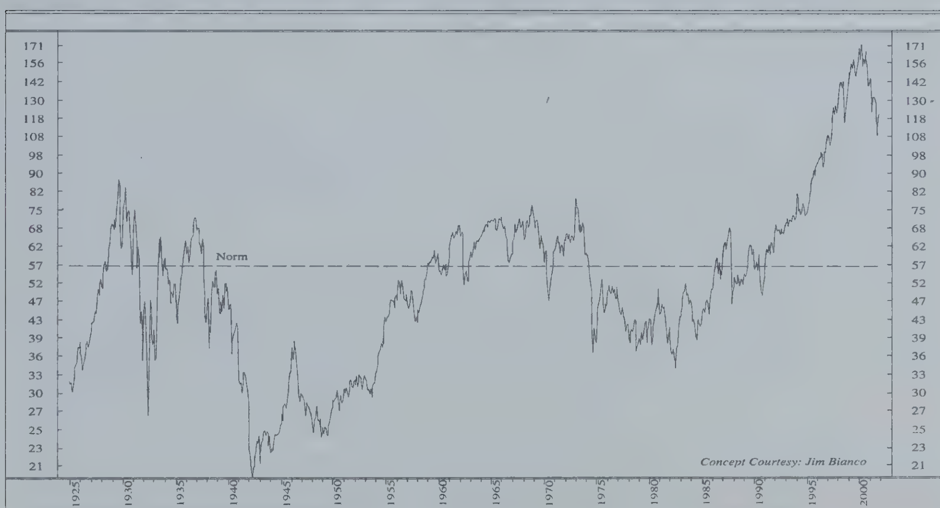
To put the recent five years in perspective, we show you the charts that we discussed at last year's annual meeting.

S&P500 Price/Operating Earnings Ratio (Excludes Write Offs) – 1927 - 2001



Source: Ned Davis Research, Inc.

Stock Market Capitalization as a Percentage of Nominal GDP – 1925 - 2001



Source: Ned Davis Research, Inc.

These charts show you why we have been so concerned about valuation levels in the U.S. market since 1998. On a price to earnings basis for the S&P500 or on a percentage of stock market capitalization to gross domestic product, recent valuation levels have never been seen in the past 100 years in the U.S. Ben Graham, the father of value investing who survived the 1929-32 stock market crash and also the 1972-74 debacle, had this to say about both periods: "What should a conservative analyst have done in the heady area and era of high growth, high-multiplier companies? I must say mournfully that he would have to do the near impossible – namely, turn his back on them and let them alone." Reflecting on his years on Wall Street, Ben made the point that "in one important respect, we have made practically no progress at all and that is in human nature . . . people still want to make money very fast." The extremely short term focus in the markets today with undue emphasis on quarterly earnings,

promotional quarterly conference calls and huge volatility in stock prices suggests Ben's observation is alive and well.

Both of the above charts show that the pendulum does swing back and forth between greed and fear – and from these levels, declines even to median historical levels would be very painful. It is important to remember that it took 25 years for the Dow Jones to break its 1929 high (of 381) and 16 years to decisively penetrate the 1000 it first reached in 1966. As we did last year, we continue to remind you that we think that most participants in today's equity markets in the U.S. will suffer permanent loss and it is very likely that recent highs in the S&P500 (1,552) and Dow Jones (11,750) will not be seen again in the next decade. When the pendulum does swing – and it seems like it has begun – the two major risks that we have discussed in the past – a potential "run" on mutual funds and the "repricing of risk" (higher default experience of bonds collateralized with consumer debt) – will be exposed.

This "off the charts" valuation level of the S&P500 has resulted in Fairfax continuing to invest in S&P500 Index puts – we currently have US$1.1 billion (notional value) at an average strike price of 1,082. After realizing gains, net of amortization, of US$7.4 million in 2001, the net cost of our S&P500 put program already expensed over the past four years is US$110.3 million. At February 28, 2002 the US$1.1 billion in S&P puts had a carrying value and market value of US$61.6 million.

The US$142 million (notional value) in similar one-year contracts on a basket of technology stocks that we discussed last year resulted in realized gains of US$48.6 million in 2001 (US$32 million in 2000). We currently have US$46 million of these contracts (with unrealized gains of US$8.7 million at February 28, 2002).

As discussed in past Annual Reports, the possibilities for realized gains continue to be:

1. We have approximately $5.5 billion invested in "put" bonds (described in our 1997 Annual Report) that have significant upside potential if interest rates decline (limited downside if interest rates increase). As a result of these put bonds, our bond portfolio has an average maturity of 8 years to the put date and 18 years to the long date.

2. We continue to have US$1.1 billion in S&P500 Index puts at an average level of 1,082, which can result in large profits if the U.S. stock market declines significantly.

3. We have $910 million invested in common stock on which we expect to make significant gains over the long term.

Our bond/common stock mix has not changed much in the last few years. We have approximately 6% of our investment portfolio in common shares and almost all the rest in cash and good quality marketable bonds (98.4% of the bonds are rated investment grade, with 83.7% being rated A or above – please see page 82). By country, our common stock investments at December 31, 2001 were as follows:

	Carrying Value	Market Value
	($ millions)	
Canada	175.5	173.7
Japan	146.8	166.5
U.S.	134.8	204.9
Other	452.7	404.6
	909.8	949.7

While we continue to be worried about the absolute levels of the U.S. stock market, as long term value investors, we have maintained our investments in North America because of a few unusual long term value oriented opportunities that came our way last year.

Miscellaneous

Please review page 100 which is an unaudited unconsolidated balance sheet showing you where your money is invested. Please note that our assets are all shown there on an equity basis while a number of the investments included in those assets are publicly traded companies with market values (which fluctuate, of course). Indirectly, through your shares of Fairfax, you own 48 million shares of Odyssey Re (book cost of $21.19 per share), 9,517,012 shares of Lindsey Morden (book cost of $10.30 per share), 11,242,201 fully diluted shares of Hub International (book cost of $11.41 per share) and 7,808,645 shares of Zenith (book cost of $43.93 per share). Also, assuming markets are willing, you will indirectly own marketable shares of Crum & Forster. The market values of these investments, over time, will help you get another reading on the long term value of your Fairfax shares and, we believe, will show you that Fairfax is worth a lot more than its book value.

We made two very small acquisitions (Winterthur (Asia) and Old Lyme) in late 2001 and early 2002. Please see pages 80 and 40 respectively for more details.

We paid a modest $1.00 per share dividend, as discussed in last year's Annual Report.

We continue to want to list on the NYSE but the Canadian dollar refuses to cooperate. We are patient. With the change in accounting for goodwill, our negative goodwill of $51.4 million will be added to common equity as of January 1, 2002 to increase book value per share to $216.64.

For many years now, we have listed for you the risks in our business (this year beginning on page 88). They are many and you should read them carefully. I want to particularly highlight for you the ones on reinsurance recoverables, taxation and ratings. The section on reinsurance recoverables beginning on page 75 of the MD&A discusses this very significant asset on our balance sheet. Dennis Gibbs and his team at RiverStone monitor this asset very carefully for us and while the risks are ever present that some of the reinsurers may default, we think Dennis

has this well in control. The settlement of all Fairfax exposures to Equitas in 2001 was an example of what RiverStone can do. The composition of the future income tax asset is discussed on page 60. Part of this asset relates to normal timing differences which arise out of ongoing operations. As for the balance, we are confident that it will be realized from future profitable operations. And finally, the claims paying rating from A.M. Best is critical to our U.S. operations. With Jonathan Godown, we are all focused on improving our ratings.

Your company has gone through a very difficult time in the past three years, particularly last year. However, in spite of these three years, we have among the best long term track records in the property and casualty industry. Since we began in 1985, our book value per share has compounded at 34% annually, while our stock price has compounded at 28%. Your management team has faced many, many problems during these 16 years but with excellent people in a team environment with no egos and a strong will, we have worked through these problems. Let me remind you of the strengths that Fairfax has that I first listed for you in the 1997 Annual Report. They are formidable and they have basically not changed.

1. Eight main established insurance companies (Commonwealth, Crum & Forster, Falcon, Federated, Lombard, Markel, Ranger and TIG) and an established international reinsurance company (OdysseyRe) with strong management teams focused on underwriting profit. These companies, together with TRG, whose expertise and ability complements our insurance and reinsurance operations, as well as the claims operations of Lindsey Morden and our investments in Hub International and Zenith, add up to a widely diversified base of over $6 billion in revenue and over $35 billion in assets.

2. An investment team with a proven track record over the long term with the ability to invest directly or indirectly in any market in the world, managing an investment portfolio of $15 billion which should produce annual investment income (interest and dividends only) of over $50 per share.

3. A lean head office team which is experienced in monitoring operations and in reacting quickly when opportunities develop, in all cases with a continuing focus on financial conservatism and protecting the company from worst case events.

4. A track record of creating wealth for shareholders over the long term while maintaining financial soundness.

5. An unbroken record of treating people fairly. A company that *has not* and *will not* compromise on its integrity.

6. A commitment to build our company over the long term — and not to flip it in the next few years. The whole focus of Fairfax is the *long term.*

In spite of much trying, we were not able to postpone our annual meeting to 2003! So our annual meeting this year will be held on Tuesday, April 16, again at 9:30 a.m. in Room 106 at the Metro Toronto Convention Centre. Our Presidents, Fairfax officers and Hamblin Watsa principals will all be there to answer questions about the future. I hope to attend!

Ken Polley retired last year as a director of Fairfax. Ken has been with us since 1986, almost since the inception of our company. He has been a great supporter of the company and a good

friend and we wish him all the very best in the future. We welcome Tony Griffiths to the Board. Tony has had a long association with us and is on many of our insurance company Boards. Given Tony's extensive turnaround experience in Canada, the timing of his election to our Board may not be inappropriate.

I want to again highlight our website for you (*www.fairfax.ca*) and remind you that all our 17 Annual Reports are readily available there, as well as links to the informative websites of our various individual companies. Our press releases are immediately posted to our website. Our quarterly reports for 2002 will be posted to our website on the following days after the market close: first quarter – May 10, second quarter – August 9 and third quarter – November 8. Our Annual Report will be posted on March 7, 2003.

Again, on your behalf, I would like to thank the Board and the management and employees of all our companies for their dedication and commitment during the toughest year we have experienced.

March 8, 2002

V. P. Watsa

V. Prem Watsa
Chairman and
Chief Executive Officer

Consolidated Financial Statements

Consolidated Balance Sheets

as at December 31, 2001 and 2000

	2001	2000
	($ millions)	
Assets		
Cash and short term investments	751.5	450.2
Marketable securities	81.9	95.2
Accounts receivable and other	3,405.2	2,917.4
Recoverable from reinsurers (note 8)	12,802.1	11,099.5
	17,040.7	14,562.3
Portfolio investments (note 2)		
Subsidiary cash and short term investments (market value – $2,254.3; 2000 – $1,955.5)	2,254.3	1,955.5
Bonds (market value – $11,424.2; 2000 – $11,295.0)	11,745.3	11,758.4
Preferred stocks (market value – $126.4; 2000 – $69.5)	126.8	70.2
Common stocks (market value – $949.7; 2000 – $859.8)	909.8	884.9
Real estate (market value – $82.7; 2000 – $76.3)	78.3	76.3
Total (market value – $14,837.3; 2000 – $14,256.1)	15,114.5	14,745.3
Investments in Hub and Zenith National	471.3	396.5
Deferred premium acquisition costs	518.0	386.7
Future income taxes (note 9)	1,718.8	1,276.2
Premises and equipment	198.1	140.8
Goodwill	274.5	259.7
Other assets	102.8	65.8
	35,438.7	31,833.3

Signed on behalf of the Board

V. P. Watsa

Director

Director

	2001	2000
	($ millions)	
Liabilities		
Lindsey Morden bank indebtedness	43.2	42.5
Accounts payable and accrued liabilities	1,826.8	1,449.4
Funds withheld payable to reinsurers	1,793.1	1,325.3
	3,663.1	2,817.2
Provision for claims (note 3)	22,085.8	20,225.8
Unearned premiums	2,645.9	2,252.4
Long term debt (note 5)	2,330.8	1,990.6
Trust preferred securities of subsidiaries (note 6)	360.8	392.0
	27,423.3	24,860.8
Non-controlling interests	1,043.3	645.2
Excess of net assets acquired over purchase price paid	51.4	129.8
Shareholders' Equity		
Common stock (note 7)	2,261.4	2,012.9
Preferred stock (note 7)	200.0	200.0
Retained earnings	796.2	1,167.4
	3,257.6	3,380.3
	35,438.7	31,833.3

Consolidated Statements of Earnings

for the years ended December 31, 2001 and 2000

	2001	2000
	($ millions – except per share amounts)	
Revenue		
Gross premiums written	6,838.0	6,054.3
Net premiums written	5,045.1	4,566.5
Net premiums earned	4,806.7	4,610.7
Interest and dividends (note 2)	680.8	818.1
Realized gains on investments (note 2)	162.3	382.8
Realized gain on OdysseyRe IPO	51.2	–
Claims fees	424.7	376.9
	6,125.7	6,188.5
Expenses		
Losses on claims	4,062.8	3,771.4
Operating expenses	1,358.2	1,263.5
Commissions, net	1,041.4	885.2
Interest expense	168.6	179.6
Restructuring and other costs	49.1	30.2
Swiss Re premiums	143.6	167.2
Kingsmead losses (note 14)	116.7	33.0
Negative goodwill	(78.6)	(108.7)
	6,861.8	6,221.4
Earnings (loss) before income taxes	(736.1)	(32.9)
Provision for (recovery of) income taxes (note 9)	(386.6)	(186.3)
Earnings (loss) from operations	(349.5)	153.4
Non-controlling interests	3.5	(16.0)
Net earnings (loss)	(346.0)	137.4
Net earnings (loss) per share (note 13)	$ (28.04)	$ 9.41

Consolidated Statements of Retained Earnings

for the years ended December 31, 2001 and 2000

	2001	2000
	($ millions)	
Retained earnings – beginning of year	1,167.4	1,049.7
Net earnings (loss) for the year	(346.0)	137.4
Excess over stated value of shares purchased for cancellation (note 7)	–	(6.3)
Preferred share dividends	(13.0)	(13.4)
Dividend tax	(12.2)	–
Retained earnings – end of year	796.2	1,167.4

Consolidated Statements of Cash Flows

for the years ended December 31, 2001 and 2000

	2001	2000
	($ millions)	
Operating activities		
Earnings (loss) from operations	(349.5)	153.4
Amortization	70.4	42.2
Future income taxes	(384.8)	(197.4)
Negative goodwill	(78.6)	(108.7)
Gains on investments	(213.5)	(382.8)
	(956.0)	(493.3)
Increase (decrease) in:		
Provision for claims	661.3	(720.4)
Unearned premiums	351.1	(122.5)
Accounts receivable and other	(330.5)	(268.9)
Recoverable from reinsurers	(1,026.6)	(983.3)
Funds withheld payable to reinsurers	368.8	(31.1)
Accounts payable and accrued liabilities	298.6	(155.6)
Other	(278.1)	98.9
Cash provided by (used in) operating activities	(911.4)	(2,676.2)
Investing activities		
Investments – purchases	(1,802.3)	(4,420.7)
– sales	2,511.2	7,414.9
Sale of marketable securities	13.3	4.2
Purchase of capital assets	(66.2)	(34.7)
Investments in Hub and Zenith National	(92.6)	(17.7)
Purchase of subsidiaries, net of cash acquired	40.3	(83.3)
Proceeds on OdysseyRe IPO (note 14)	436.9	–
Cash provided by (used in) investing activities	1,040.6	2,862.7
Financing activities		
Subordinate voting shares (note 7)	248.5	(59.7)
Trust preferred securities of subsidiary (note 6)	(54.1)	–
Long term debt – advances (note 14)	231.9	–
Long term debt – repayment	(11.6)	(166.3)
Bank indebtedness	0.9	(1.3)
Preferred share dividends	(13.0)	(13.4)
Cash provided by (used in) financing activities	402.6	(240.7)
Foreign currency translation	68.3	–
Increase (decrease) in cash resources	600.1	(54.2)
Cash resources – beginning of year	2,405.7	2,459.9
Cash resources – end of year	3,005.8	2,405.7

Cash resources consist of cash and short term investments, including subsidiary cash and short term investments. Short term investments are readily convertible into cash and have maturities of three months or less.

Auditors' Report to the Shareholders

We have audited the consolidated balance sheets of Fairfax Financial Holdings Limited as at December 31, 2001 and 2000 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
Toronto, Canada

February 6, 2002

Valuation Actuary's Report

I have reviewed management's valuation, including management's selection of appropriate assumptions and methods, of the policy liabilities of the subsidiary insurance and reinsurance companies of Fairfax Financial Holdings Limited in its consolidated balance sheet as at December 31, 2001 and their change as reflected in its consolidated statement of earnings for the year then ended, in accordance with Canadian accepted actuarial practice.

In my opinion, management's valuation is appropriate, except as noted in the following paragraph, and the consolidated financial statements fairly present its results.

Under Canadian accepted actuarial practice, the valuation of policy liabilities reflects the time value of money. Management has chosen not to reflect the time value of money in its valuation of the policy liabilities.

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February 6, 2002

Notes to Consolidated Financial Statements

for the years ended December 31, 2001 and 2000
(in $ millions except per share amounts and as otherwise indicated)

1. Summary of Significant Accounting Policies

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenue and expenses during the periods covered by the financial statements. Actual results could differ from those estimates.

Business operations

The company is a financial services holding company which, through its subsidiaries, is principally engaged in property and casualty insurance conducted on a direct and reinsurance basis, investment management and insurance claims management.

Principles of consolidation

The consolidated financial statements include the accounts of the company and all of its subsidiaries:

Insurance

Commonwealth Insurance Company
Crum & Forster Holdings, Inc.
Falcon Insurance Company Limited
Federated Insurance Holdings of Canada Ltd.
Lombard General Insurance Company of Canada
Markel Insurance Company of Canada
Ranger Insurance Company
TIG Specialty Insurance Company

Reinsurance group

Odyssey Re Holdings Corp.

Other reinsurance subsidiaries

Compagnie Transcontinentale de Réassurance
CRC (Bermuda) Reinsurance Limited
ORC Re Limited
Wentworth Insurance Company Ltd.

Runoff

RiverStone Stockholm Insurance Corporation (publ)
Sphere Drake Limited
The Resolution Group, Inc.

Other

Hamblin Watsa Investment Counsel Ltd. (investment management)
Lindsey Morden Group Inc. (insurance claims management)
RiverStone Management Limited (runoff claims management)

All subsidiaries are wholly-owned except for Odyssey Re Holdings with a voting and equity interest of 73.7% (note 14), The Resolution Group with an effective 27.5% economic and 100% voting interest, and Lindsey Morden with a 66.5% equity and 85.9% voting interest. The company has investments in Hub International Limited with a 36.8% (2000 – 41.7%) equity interest and Zenith National Insurance Corp. with a 42.0% (2000 – 39.0%) equity interest. The

company has an agreement with Zenith National that it will not seek to control or influence Zenith's Board of Directors, management or policies.

Acquisitions are accounted for by the purchase method, whereby the results of acquired companies are included only from the date of acquisition. Divestitures are included up to the date of disposal.

Premiums
Insurance and reinsurance premiums are taken into income evenly throughout the terms of the related policies.

Deferred premium acquisition costs
Certain costs, consisting of brokers' commissions and premium taxes, of acquiring insurance premiums are deferred, to the extent that they are considered recoverable, and charged to income as the premiums are earned. The ultimate recoverability of deferred premium acquisition costs is determined without regard to investment income.

Investments
Bonds are carried at amortized cost providing for the amortization of the discount or premium on a yield to maturity basis. Preferred and common stocks are carried at cost. Real estate is carried at book value. When there has been a loss in value of an investment that is other than temporary, the investment is written down to its estimated net realizable value. Such writedowns are reflected in realized gains (losses) on investments. At December 31, 2001, the aggregate provision for losses on investments was $37.4 (2000 – $22.7).

The company purchases foreign currency forward contracts to hedge its foreign equity portfolio. At December 31, 2001, the company held Yen 11.6 billion (2000 – Yen 22.5 billion) of such contracts, maturing in 2002 and 2003. Once the securities are sold, the contracts are closed out and any gain or loss is then included in realized gains (losses) on investments. Gains or losses on contracts in excess of hedging requirements are recorded in earnings as they arise.

Provision for claims
Claim provisions are established by the case method as claims are reported. For reinsurance, the provision for claims is based on reports and individual case estimates received from ceding companies. The estimates are regularly reviewed and updated as additional information on the estimated claims becomes known and any resulting adjustments are included in earnings. A provision is also made for management's calculation of factors affecting the future development of claims including claims incurred but not reported (IBNR) based on the volume of business currently in force and the historical experience on claims.

Translation of foreign currencies
Assets and liabilities in foreign currencies are translated into Canadian dollars at year-end exchange rates. Revenues and expenses are translated at the exchange rates in effect at the date incurred. Realized gains and losses on foreign exchange transactions are recognized in the statements of earnings.

The operations of the company's subsidiaries (principally in the United States, France and the United Kingdom) are self-sustaining. As a result, the assets and liabilities of these subsidiaries are translated at the year-end rates of exchange. Revenue and expenses are translated at the average rate of exchange for the year. The company enters into foreign currency contracts from time to time to hedge the foreign currency exposure related to its net investments in self-sustaining foreign operations. Such contracts are translated at the year-end rates of exchange.

At December 31, 2001, the company had foreign currency contracts hedging its self-sustaining subsidiaries, maturing as follows:

	Notional Value *(US$)*
2002	750
2003	925
2004	130
2006	200
2007	420
2008	75
	2,500

Certain of the contracts due in 2007 and 2008 have an early termination option which reduces the term from ten years to five years. If exercised, an additional US$270 and US$75 in notional value would mature in 2002 and 2003 respectively.

Goodwill

The excess of purchase cost over the fair value of the net assets of acquired businesses is amortized on the straight line basis over their estimated useful lives which range from ten years for Hamblin Watsa Investment Counsel Ltd. and insurance company acquisitions to forty years for Lindsey Morden Group Inc. Effective January 1, 2002, in accordance with changes to Canadian generally accepted accounting principles (GAAP), goodwill will no longer be amortized to earnings over its estimated useful life. The remaining carrying value of goodwill will be charged to earnings when it is determined that an impairment in value exists. The company assesses the carrying value of goodwill based on the underlying undiscounted cash flows and operating results of the subsidiaries.

The excess of the fair value of net assets acquired over the purchase price paid (negative goodwill) for acquired businesses is amortized to earnings over periods of three to six years. The company periodically reviews the appropriateness of the remaining amortization period of the negative goodwill based on its evaluation of the facts and circumstances giving rise to the original negative goodwill at the various acquisition dates. Prior to the fourth quarter of 2000, all negative goodwill was amortized to earnings on a straight line basis over ten years. The company carried out a comprehensive review of the remaining useful life of the negative goodwill for each acquisition which resulted in a change in the various amortization periods. This change in estimate was applied on a prospective basis effective at the beginning of the fourth quarter of 2000, resulting in an increase in negative goodwill amortization of $79.2 for

the year ended December 31, 2000. Effective January 1, 2002, in accordance with changes in Canadian GAAP, the negative goodwill balance will be added to shareholders' equity.

Reinsurance

The company reflects third party reinsurance balances on the balance sheet on a gross basis to indicate the extent of credit risk related to third party reinsurance and its obligations to policyholders and on a net basis in the statement of earnings to indicate the results of its retention of premiums written.

Income taxes

Income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities and their tax bases based on tax rates which are expected to be in effect when the asset or liability is settled.

2. Investment Information

Portfolio investments comprise:

	2001		2000	
	Carrying Value	**Estimated Fair Value**	**Carrying Value**	**Estimated Fair Value**
Subsidiary cash and short term				
Investments	2,254.3	2,254.3	1,955.5	1,955.5
Bonds				
Canadian – government	723.0	739.3	851.9	798.3
– corporate	395.2	388.4	237.9	223.6
U.S. – government	4,527.3	4,369.1	4,278.7	4,200.5
– corporate	4,635.6	4,482.7	5,040.5	4,761.2
Other – government	1,419.0	1,399.2	1,181.5	1,158.4
– corporate	45.2	45.5	167.9	153.0
Preferred stocks				
Canadian	126.8	126.4	70.2	69.5
Common stocks				
Canadian	175.5	173.7	166.5	165.7
U.S.	134.8	204.9	122.0	124.7
Other	599.5	571.1	596.4	569.4
Real estate	78.3	82.7	76.3	76.3
	15,114.5	14,837.3	14,745.3	14,256.1

The estimated fair values of preferred and common stocks and debt securities are based on quoted market values.

Management has reviewed currently available information regarding those investments whose estimated fair value is less than carrying value, amounting to an aggregate unrealized loss of $547.9 at December 31, 2001 (2000 – $603.0), and has determined that the carrying values are expected to be recovered. Debt securities whose carrying value exceeds market value can be held until maturity. Preferred and common stock investments have been reviewed to ensure

that corporate performance expectations have not changed significantly to adversely affect the market value of these securities other than on a temporary basis.

The company's subsidiaries have pledged (either directly or indirectly to support letters of credit) cash and investments of $3.6 billion as security for reinsurance balances and regulatory deposits (including $443.0 of intercompany trust funds).

Liquidity and Interest Rate Risk

Maturity profile as at December 31, 2001:

	Within 1 Year	1 to 5 Years	6 to 10 Years	Over 10 Years	Total
Bonds (carrying value)	$ 530.1	$4,247.7	$4,500.2	$2,467.3	$11,745.3
Effective interest rate					5.7%

Bonds are classified at the earliest of the available maturity dates.

Investment Income

	2001	2000
Interest and dividends:		
Cash and short term investments	85.1	109.5
Bonds	540.6	655.6
Preferred stocks	3.6	4.7
Common stocks	59.8	54.2
	689.1	824.0
Expenses	(8.3)	(5.9)
	680.8	818.1
Realized gains on investments:		
Bonds	28.4	22.3
Preferred stocks	0.6	(0.2)
Common stocks	172.6	403.0
OdysseyRe IPO	51.2	–
Other	(1.9)	(20.9)
Provision for losses	(37.4)	(21.4)
	213.5	382.8
Net investment income	894.3	1,200.9

3. Provision for Claims

The provisions for unpaid claims and adjustment expenses and for the third party reinsurers' share thereof are estimates subject to variability, and the variability could be material in the near term. The variability arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Variability can be caused by receipt of additional claim information, changes in judicial interpretation of contracts or liability or

significant changes in severity or frequency of claims from historical trends. The estimates are principally based on the company's historical experience. Methods of estimation have been used which the company believes produce reasonable results given current information.

Changes in claim liabilities recorded on the balance sheet for the years ended December 31, 2001 and 2000 and their impact on unpaid claims and adjustment expenses for these two years are as shown in the following table:

	2001	2000
Unpaid claim liabilities – beginning of year – net	11,154.8	12,179.5
Foreign exchange effect of change in claim liabilities	690.8	388.6
Increase in estimated losses and expenses for losses occurring in prior years	494.7	680.4
Recovery under Swiss Re cover	(325.4)	(404.0)
Provision for losses and expenses on claims occurring in the current year	3,991.8	3,465.2
Paid on claims occurring during:		
the current year	(1,072.4)	(983.9)
prior years	(4,254.6)	(4,242.4)
Unpaid claim liabilities at December 31 of:		
Seneca	–	71.4
Winterthur (Asia)	25.7	–
Unpaid claim liabilities – end of year – net	10,705.4	11,154.8
Unpaid claim liabilities at December 31 of Federated Life	29.4	30.7
Unpaid claim liabilities – end of year – net	10,734.8	11,185.5
Reinsurance gross-up	11,351.0	9,040.3
Unpaid claim liabilities – end of year – gross	22,085.8	20,225.8

The foreign exchange effect of change in claim liabilities results from the fluctuation of the value of the Canadian dollar in relation to the U.S. dollar and European currencies.

The basic assumptions made in establishing actuarial liabilities are best estimates of possible outcomes. The company presents its claims on an undiscounted basis.

The company's provision for asbestos, pollution and other hazards claims is set out in the first table on page 73 of the MD&A.

As part of its acquisition strategy, the company generally obtains vendor indemnifications from adverse development in the acquired company's claims reserves and unrecoverable reinsurance. A summary of these indemnifications is set out in the table on page 79 of the MD&A.

4. Contingent Value Rights

As part of the consideration for the purchase of Sphere Drake, the company issued contingent value rights ("CVRs") of US$170.4 (including effectively 8% interest per annum) payable in 2007, subject to earlier redemption at the option of the company. The amount payable at

maturity is subject to adjustments for the development of Sphere Drake's provision for claims as at December 31, 1996, the development of Sphere Drake's reserves for unrecoverable receivables from reinsurers and indemnifiers as at December 31, 1996, the result of commutations and certain actuarial expenses. At December 31, 2001, adverse development has amounted to US$195.8, which is US$25.4 in excess of the face value of the CVR obligation, thus reducing it to nil.

5. Long Term Debt

The long term debt at December 31 consists of the following balances:

	2001	2000
Fairfax unsecured senior notes of US$100 at 7.75% due December 15, 2003	159.6	150.2
Fairfax unsecured senior note at 7.75% due December 15, 2003	25.0	25.0
Fairfax unsecured senior notes of US$275 at $7^3/_8$% due March 15, 2006[3]	439.0	413.0
Fairfax FF300 unsecured debt at $2^1/_2$% due February 27, 2007 (effectively a FF200 debt at 8%)	52.9	52.5
Fairfax unsecured senior notes of US$175 at 6.875% due April 15, 2008[1]	279.4	262.8
Fairfax unsecured senior notes of US$100 at 8.25% due October 1, 2015[1]	159.6	150.2
Fairfax unsecured senior notes of US$225 at 7.375% due April 15, 2018[1][2]	359.2	338.0
Fairfax unsecured senior notes of US$125 at 8.30% due April 15, 2026[1]	199.5	187.8
Fairfax unsecured senior notes of US$125 at 7.75% due July 15, 2037[1]	199.5	187.8
TIG senior unsecured non-callable notes of US$100 at 8.125% due April 15, 2005	158.6	148.9
Other long term debt of TIG	22.6	27.8
OdysseyRe senior unsecured non-callable notes of US$100 at 7.49% due November 30, 2006	159.6	–
Other long term debt of OdysseyRe	79.8	–
Lindsey Morden unsecured Series B debentures at 7% due June 16, 2008	125.0	125.0
Other long term debt of Lindsey Morden	8.2	14.2
	2,427.5	2,083.2
Less: Lindsey Morden debentures held by Fairfax	(8.2)	(8.2)
Fairfax debentures held by subsidiaries	(88.5)	(84.4)
	2,330.8	1,990.6

(1) *In prior years, the company entered into various interest rate swap agreements on the above-noted debt as a result of which it pays interest on that debt at a rate linked to LIBOR or as noted in (2) below.*

(2) *During 1998, the company swapped US$125 of its debt at 7.375% due April 15, 2018 for Japanese yen denominated debt of the same maturity, with fixed interest at 3.48% per annum. The pre-tax unrealized gain, net of accumulated amortization, on the foreign exchange component of the yen debt swap amounted to $1.6 at December 31, 2001 and is being amortized to earnings over the remaining term to maturity.*

(3) *During 2001, the company closed out the swap for this debt and deferred the resulting gain of approximately $25 which will be amortized to earnings over the remaining term to maturity.*

Interest expense on long term debt amounted to $164.3 (2000 – $174.1). Interest expense on Lindsey Morden's bank indebtedness amounted to $4.3 (2000 – $5.5).

Principal repayments are due as follows:

2002	19.3
2003	192.8
2004	5.3
2005	240.0
2006	559.8
Thereafter	1,313.6

6. Trust Preferred Securities of Subsidiaries

TIG Holdings has issued $199.5 (US$125) of 8.597% junior subordinated debentures to TIG Capital Trust (a statutory business trust subsidiary of TIG Holdings) which, in turn, issued US$125 of 8.597% mandatory redeemable capital securities, maturing in 2027. On March 21, 2001, one of the company's subsidiaries acquired US$35 of these trust preferred securities for approximately US$24.5.

Fairfax RHINOS Trust (a statutory business trust subsidiary of Fairfax Inc.) has issued $217.1 (US$136) of Redeemable Hybrid Income Overnight Shares (RHINOS) (136,000 trust preferred securities) with a distribution rate of LIBOR plus 150 basis points maturing February 24, 2003. The company has agreed to issue US$136 of subordinate voting shares (or convertible preferred shares) by November 24, 2002, which proceeds will be used to mandatorily redeem the outstanding RHINOS.

7. Capital Stock

Authorized capital

The authorized share capital of the company consists of an unlimited number of preferred shares issuable in series, an unlimited number of multiple voting shares carrying ten votes per share and an unlimited number of subordinate voting shares carrying one vote per share.

Issued capital

	2001 number		2000 number	
Multiple voting shares	1,548,000	5.0	1,548,000	5.0
Subordinate voting shares	13,602,118	2,275.4	12,352,118	2,026.9
	15,150,118	2,280.4	13,900,118	2,031.9
Interest in shares held through ownership interest in shareholder	(799,230)	(19.0)	(799,230)	(19.0)
Net shares effectively outstanding	14,350,888	2,261.4	13,100,888	2,012.9
Fixed/floating cumulative redeemable preferred shares, Series A, with a fixed dividend of 6.5% per annum until November 30, 2004 and stated capital of $25 per share	8,000,000	200.0	8,000,000	200.0

On November 20, 2001, the company issued 1,250,000 subordinate voting shares at $200 per share for net proceeds of $248.5.

In 2000, under the terms of normal course issuer bids approved by The Toronto Stock Exchange, the company purchased and cancelled 325,309 subordinate voting shares for an aggregate cost of $59.7, of which $6.3 was charged to retained earnings.

8. Reinsurance

The company follows the policy of underwriting and reinsuring contracts of insurance and reinsurance which, depending on the type of contract, generally limits the liability of the individual insurance and reinsurance subsidiaries to a maximum amount on any one loss of $7.5. Reinsurance is generally placed on an excess of loss basis in several layers. The company's reinsurance does not, however, relieve the company of its primary obligation to the policyholders.

The company has guidelines and a review process in place to assess the creditworthiness of the companies to which it cedes.

The company makes specific provisions against reinsurance recoverable from companies considered to be in financial difficulty. In addition, the company records a general allowance based upon analysis of historical recoveries, the level of allowance already in place and management's judgment. The allocation of the allowance for loss is as follows:

	2001	2000
Specific	816.9	785.2
General	219.2	134.7
Total	1,036.1	919.9

A summary of the company's reinsurance recoverable by A.M. Best rating of the responsible reinsurers and outstanding balance at December 31, 2001 is set out in the table on page 78 of the MD&A.

During the year, the company ceded premiums earned of $1,908.7 (2000 – $1,427.1) and $3,591.6 (2000 – $2,540.6) of claims incurred.

9. Income Taxes

The provision for income taxes differs from the statutory tax rate as certain sources of income are exempt from tax or are taxed at other than the statutory rate.

A reconciliation of income tax calculated at the statutory tax rate with the income tax provision at the effective tax rate in the financial statements is summarized in the following table:

	2001	2000
Provision for (recovery of) income taxes at statutory income tax rate	(309.2)	(14.5)
Non-taxable investment income	(56.4)	(13.7)
Income earned outside Canada	11.2	(149.8)
Negative goodwill amortization	(33.0)	(49.5)
Change in tax rate for future income taxes	1.4	7.9
Unrecorded tax benefit of losses and utilization of prior years' losses	(0.6)	33.3
Provision for (recovery of) income taxes	(386.6)	(186.3)

Future income taxes of the company are as follows:

	2001	2000
Operating and capital losses	1,182.4	784.7
Claims discount	394.8	437.0
Unearned premium reserve	120.9	104.8
Deferred premium acquisition cost	(131.0)	(104.3)
Investments	(9.1)	(24.8)
Allowance for doubtful accounts	55.1	16.7
Other	164.4	130.1
Valuation allowance	(58.7)	(68.0)
Future income taxes	1,718.8	1,276.2

Management reviews the valuation of the future income taxes on an ongoing basis and adjusts the valuation allowance, as necessary, to reflect its anticipated realization. Management expects that these future income taxes will be realized in the normal course of operations.

10. Statutory Requirements

The company's insurance and reinsurance subsidiaries are subject to certain requirements and restrictions under their respective insurance company Acts including minimum capital requirements and dividend restrictions.

The company can receive up to $232 in 2002 as dividends from insurance and reinsurance subsidiaries without obtaining the prior approval of insurance regulators.

At December 31, 2001, statutory surplus, determined in accordance with the various insurance regulations, amounted to $3.4 billion for the insurance subsidiaries, $1.4 billion for the reinsurance subsidiaries and $1.1 billion for the runoff subsidiaries.

11. Contingencies and Commitments

In 2000, the legal proceedings commenced by Sphere Drake in 1999 against a group of agents and intermediaries whom it alleged fraudulently obtained and utilized a binding authority to write reinsurance contracts which expose Sphere Drake to significantly under-priced U.S. workers' compensation business, which was filed in New York, was dismissed as to most defendants primarily on the ground that London, England was a more convenient forum in which the dispute should be resolved. Sphere Drake subsequently commenced proceedings in London, England against its agent and the agent of the cedants, alleging fraud and breach of duty. Sphere Drake has rescinded the majority of the inward reinsurance contracts placed under the binding authority and is defending arbitration proceedings initiated by the cedants of a number of those contracts. It is not yet possible to develop any reasonably based estimates of the amount of claims which might be made on these contracts. However, based on extensive legal advice, Sphere Drake believes that there is abundant evidence of fraud and that it has substantial grounds to challenge the enforceability of the business bound on its behalf. While the eventual outcome is uncertain, the company believes that the likely ultimate net liability which might arise in respect of this business will not be material to Sphere Drake's financial position.

Subsidiaries of the company are also defendants in several damage suits and have been named as third party in other suits. The uninsured exposure to the company is not considered to be material to the company's financial position.

Unsecured letters of credit aggregating $502 have been issued upon the company's application and have been pledged as security for subsidiaries' reinsurance balances, principally relating to intercompany reinsurance between subsidiaries. These are unsecured letters of credit in addition to the secured letters of credit referred to in note 2.

The company under certain circumstances may be obligated to purchase loans to officers and directors of the company and its subsidiaries from Canadian chartered banks totalling $18.3 (2000 – $16.6) for which 268,911 (2000 – 315,861) subordinate voting shares of the company with a year-end market value of $44.1 (2000 – $72.2) have been pledged as security.

The company also has a restricted stock plan for the management of its subsidiaries with vesting periods of up to ten years from the date of grant. At December 31, 2001, 230,800

(2000 – 227,338) subordinate voting shares had been purchased for the plan at a cost of $66.9 (2000 – $66.9).

Shares for the above-mentioned plans are purchased on the open market. The costs of these plans are amortized to compensation expense over the vesting period. Amortization expense for the year for these plans amounted to $7.9 (2000 – $6.2).

12. Operating Leases

Aggregate future minimum commitments at December 31, 2001 under operating leases relating to premises, automobiles and equipment for various terms up to ten years are as follows:

2002	102.2
2003	83.2
2004	67.9
2005	56.7
2006	46.7
Thereafter	112.2

13. Earnings per Share

Earnings per share are calculated after providing for dividends and dividend tax on the Series A fixed/floating cumulative redeemable preferred shares.

Diluted and basic earnings per share are the same in 2001 and 2000. The weighted average number of shares for 2001 was 13,241,299 (2000 – 13,172,448).

14. Acquisitions and Divestitures

Effective January 1, 2002, pending regulatory approval, the company has agreed either directly or through subsidiaries to acquire Old Lyme Insurance Company of Rhode Island, Inc. and Old Lyme Insurance Company Ltd. from its equity investee, Hub International Limited, for cash consideration estimated to be US$42.0 (Cdn$67.0), the fair value of the net assets to be acquired.

Effective December 20, 2001, the company purchased Winterthur Swiss Insurance (Asia) Limited for US$14.5 (Cdn$23.1) cash. At the date of acquisition, the company had US$122.7 (Cdn$195.8) in total assets and US$108.2 (Cdn$172.7) in total liabilities.

On June 14, 2001, Odyssey Re Holdings Corp. (ORH), the U.S. holding company for Odyssey America Re and its subsidiaries, issued 17,142,857 common shares, in an initial public offering, at US$18 per share for net proceeds (after expenses of issue) of US$284.8 (Cdn$436.9). Fairfax and its wholly-owned subsidiary, TIG, received US$233.5 (Cdn $354.4) in cash from these proceeds. After the offering, Fairfax and TIG held 48 million (73.7%) of ORH's common shares and a US$200 (Cdn $303.5) ORH three year term note bearing interest at the rate of 2.25% over LIBOR and repayable in annual principal payments of US$66.7 beginning June 30, 2002. The company recorded a gain of $51.2 on its effective sale of a 26.3% interest in ORH. At December 31, 2001, US$150 of ORH's term note had been refinanced and the proceeds paid to the company.

Effective August 31, 2000, Crum & Forster purchased Sen-Tech Holdings, Inc. (and its wholly-owned subsidiary, Seneca Insurance Company, Inc. of New York) for US$65 (Cdn$96) cash. Effective December 21, 2000, Crum & Forster also purchased Transnational Insurance Company for US$17 (Cdn$26) cash. At the respective dates of acquisition, the companies had US$193 in total assets and US$119 in total liabilities, at fair value, resulting in goodwill of US$8 which is being amortized on a straight line basis over 10 years.

As part of the acquisition of TIG on April 13, 1999, the company acquired a 90% ownership in Kingsmead Managing Agency, a managing agent for three Lloyd's syndicates for which TIG provided underwriting capacity. On June 29, 2000, the company entered into an agreement to sell Kingsmead to Advent Capital plc for a 22% interest in Advent, which closed on November 16, 2000. There was no gain or loss on the sale. The company recorded operating losses from the Kingsmead-managed syndicates of $33.0 for the year ended December 31, 2000. For the year ended December 31, 2001, the company recorded a loss of $116.7 from its liability for 2000 and prior underwriting years of those syndicates. The losses reflect losses on unexpired policies from the 2000 underwriting year (including World Trade Center losses of $62.4) and adverse development from the open underwriting years.

15. Segmented Information

The company is a financial services holding company which, through its subsidiaries, is primarily engaged in property and casualty insurance conducted on a direct and reinsurance basis. The runoff business segment comprises the company's interest in The Resolution Group ("TRG") and its wholly-owned subsidiary, International Insurance, Sphere Drake and RiverStone Stockholm. The international runoff operations have reinsured their reinsurance portfolios to ORC Re to provide consolidated investment and liquidity management services, with the RiverStone Group retaining full responsibility for all other aspects of the runoff. Accordingly, for segmented information, ORC Re is classified in the Runoff segment. The company also provides claims adjusting, appraisal and loss management services.

	Canada		United States		Europe and Far East		Total	
	2001	**2000**	**2001**	**2000**	**2001**	**2000**	**2001**	**2000**
Revenue								
Net premiums earned								
Insurance – Canada	661.0	600.3	46.3	36.9	22.9	19.0	730.2	656.2
Insurance – US	–	–	2,510.5	2,416.9	16.9	–	2,527.4	2,416.9
Reinsurance	–	–	1,054.6	813.1	337.7	411.2	1,392.3	1,224.3
Runoff	–	–	0.4	0.4	156.4	312.9	156.8	313.3
	661.0	600.3	3,611.8	3,267.3	533.9	743.1	4,806.7	4,610.7
Interest and dividends							680.8	818.1
Realized gains							213.5	382.8
Claims fees							424.7	376.9
							6,125.7	6,188.5
	13.8%	13.0%	75.1%	70.9%	11.1%	16.1%		
Earnings (loss) before income taxes								
Underwriting results								
Insurance – Canada	(76.1)	(9.7)	(29.1)	5.2	(14.3)	(8.5)	(119.5)	(13.0)
Insurance – US	–	–	(633.9)	(588.4)	(4.0)	–	(637.9)	(588.4)
Reinsurance	–	–	(149.2)	(94.7)	(65.5)	(2.7)	(214.7)	(97.4)
	(76.1)	(9.7)	(812.2)	(677.9)	(83.8)	(11.2)	(972.1)	(698.8)
Interest and dividends	64.7	72.3	425.9	520.3	1.1	0.9	491.7	593.5
Operating income (loss)	(11.4)	62.6	(386.3)	(157.6)	(82.7)	(10.3)	(480.4)	(105.3)
Realized gains							213.5	378.3
Runoff							(27.4)	43.3
Claims adjusting							(9.9)	(36.2)
Interest expense							(155.2)	(164.7)
Swiss Re premium							(143.6)	(167.2)
Kingsmead losses							(116.7)	(33.0)
Restructuring charges							(49.1)	(16.4)
Negative goodwill amortization							78.6	108.7
Corporate overhead and other							(45.9)	(40.4)
							(736.1)	(32.9)
Identifiable assets								
Insurance	2,586.9	1,849.8	16,039.8	14,256.1	245.1	31.4	18,871.8	16,137.3
Reinsurance	6.6	7.8	7,419.1	6,424.4	–	1,296.1	7,425.7	7,728.3
Claims adjusting	55.5	47.6	70.9	63.8	331.7	331.4	458.1	442.8
Runoff	–	–	3,332.2	3,100.6	4,145.1	3,538.5	7,477.3	6,639.1
	2,649.0	1,905.2	26,862.0	23,844.9	4,721.9	5,197.4	34,232.9	30,947.5
Corporate							1,205.8	885.8
							35,438.7	31,833.3
	7.5%	6.0%	75.8%	74.9%	13.3%	16.3%		
Amortization	7.7	3.4	36.8	17.3	25.9	21.5	70.4	42.2

Geographic premiums are determined based on the domicile of the various subsidiaries and where the primary underlying risk of the business resides.

CRC (Bermuda) is included in the Canadian segment and Falcon is included in the United States segment.

Corporate overhead and other includes the company's interest expense and corporate overhead. Corporate assets include cash and short term investments and miscellaneous other assets in the holding company.

16. Fair Value

Information on the fair values of financial instruments of the company where those values differ from their carrying values in the financial statements at December 31, 2001 include:

	Note Reference	Carrying Value	Estimated Fair Value
Marketable securities	2	81.9	88.3
Portfolio investments	2	15,114.5	14,837.3
Investments in Hub and Zenith National	–	471.3	525.4
Long term debt	5	2,330.8	1,625.9
Trust preferred securities of subsidiaries	6	360.8	221.8
Foreign exchange contracts	1	(331.5)	(331.5)
Debt and interest rate swaps	5	–	45.7

Included in marketable securities at December 31, 2001 were S&P put contracts with a weighted average strike price of 1,054 and a notional value of US$900. The premiums paid to acquire these contracts are being charged to realized gains on equity investments on a straight line basis over their terms to maturity during 2002.

The unrealized loss on foreign exchange contracts is offset by an unrealized gain on the value of the foreign assets hedged by those contracts.

The amounts above do not include the fair value of underlying lines of business. While fair value amounts are designed to represent estimates of the amounts at which instruments could be exchanged in current transactions between willing parties, certain of the company's financial instruments lack an available trading market. Therefore, these instruments have been valued on a going concern basis. Fair value information on the provision for claims is not determinable.

These fair values have not been reflected in the financial statements.

17. US GAAP Reconciliation

The consolidated financial statements of the company have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") which are different in some respects from those applicable in the United States, as described below.

Consolidated Statements of Earnings

For the years ended December 31, 2001 and 2000, significant differences between consolidated net earnings under Canadian GAAP and consolidated net earnings under US GAAP were as follows:

(a) In Canada, the unrealized loss on the translation of the foreign exchange component of the yen debt swap is deferred and amortized to income over the remaining term to maturity. In the U.S., the unrealized foreign exchange loss is recognized in income in the year, although there is no intention to settle the swap prior to maturity.

(b) In Canada, recoveries on certain stop loss reinsurance treaties (including with Swiss Re) protecting Fairfax, Crum & Foster and TIG are recorded at the same time as the claims incurred are ceded. In the U.S., these recoveries, which are considered to

be retroactive reinsurance, are recorded up to the amount of the premium paid with the excess of the ceded liabilities over the premium paid recorded as a deferred gain. The deferred gain is amortized to income over the estimated settlement period over which the company expects to receive the recoveries.

(c) In Canada, the amortization period of negative goodwill is periodically reviewed to determine whether the remaining useful life continues to be appropriate or whether the amortization period should be adjusted, based on the facts and circumstances giving rise to the negative goodwill at the date of acquisition. In the U.S., in the case of financial institutions, the SEC staff generally take exception to a negative goodwill amortization period of less than 10 years.

(d) Under Canadian GAAP, the Canadian federal and provincial income tax rate reductions that are substantively enacted are reflected in the rate used to measure future income tax balances. Under US GAAP, Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes", these rate changes do not impact the measurement of the company's future income tax balances until they are passed into law.

(e) For United States reporting purposes, the company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities", for the year ended December 31, 2001.

Under this standard, all derivatives are recognized at fair value in the balance sheet. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivative will either be offset in earnings against the change in the fair value of the hedged item or will be recognized in other comprehensive income until the hedged item is recognized in earnings. If the change in the fair value of the derivative is not completely offset by the change in the value of the item it is hedging, the difference will be recognized immediately in earnings.

The company's forward contracts are hedges of net investments in subsidiaries and therefore there is no impact as a result of this Standard.

The following shows the net earnings in accordance with US GAAP:

	2001	**2000**
Net earnings (loss), Canadian GAAP	(346.0)	137.4
Foreign exchange gain on yen debt swap, net of tax	16.0	9.2
Recoveries on retroactive reinsurance, net of tax	(411.9)	(159.6)
Amortization of negative goodwill	(49.1)	(79.2)
Change in tax rate for future income taxes	(6.5)	7.9
Net earnings (loss), US GAAP	(797.5)	(84.3)
Net earnings (loss) per share, US GAAP	$ (62.13)	$ (7.42)

Consolidated Balance Sheets

In Canada, portfolio investments are carried at cost or amortized cost with a provision for declines in value which are considered to be other than temporary. In the U.S., such investments are classified as available for sale and marked to market through shareholders' equity.

In Canada, trust preferred securities of subsidiaries (including RHINOS) are included in total liabilities. In the U.S., trust preferred securities are shown as a separate caption after total liabilities, in a manner similar to non-controlling interests.

The following shows the balance sheet amounts in accordance with US GAAP, setting out individual amounts where different from the amounts reported under Canadian GAAP:

	2001	2000
Assets		
Portfolio investments		
Bonds	11,424.2	11,295.0
Preferred stocks	126.4	69.5
Common stocks	949.7	859.8
Total portfolio investments	12,500.3	12,224.3
Future income taxes	2,273.3	1,634.5
Goodwill	356.8	352.1
All other assets	20,663.5	17,583.9
Total assets	35,793.9	31,794.8
Liabilities		
Accounts payable and accrued liabilities	2,936.3	1,935.5
All other liabilities	28,898.8	25,836.6
Total liabilities	31,835.1	27,772.1
Trust preferred securities of subsidiaries	360.8	392.0
Non-controlling interest	1,043.3	645.2
Excess of net assets acquired over purchase price paid	179.7	209.1
	1,583.8	1,246.3
Shareholders' Equity		
Total shareholders' equity	2,375.0	2,776.4

The difference in consolidated shareholders' equity is as follows:

	2001	2000
Shareholders' equity based on Canadian GAAP	3,257.6	3,380.3
Other comprehensive income	(163.3)	(336.1)
Cumulative reduction in net earnings under US GAAP	(719.3)	(267.8)
Shareholders' equity based on US GAAP	2,375.0	2,776.4

Statement of Financial Accounting Standards No. 130 "Reporting Comprehensive Income" requires the company to disclose items of other comprehensive income in a financial statement and to disclose accumulated balances of other comprehensive income in the equity section of a financial statement. Other comprehensive income includes unrealized gains and losses on investments, as follows:

	2001	**2000**
Unrealized gain (loss) on investments available for sale	(281.6)	(489.2)
Less: related deferred income taxes	118.3	153.1
	(163.3)	(336.1)

The cumulative reduction in net earnings under US GAAP of $719.3 at December 31, 2001 relates to the deferred gain on retroactive reinsurance ($595.7 after tax) which is amortized into income as the underlying claims are paid, and the difference in amortization period of negative goodwill ($128.3) which reverses in full on January 1, 2002, offset by miscellaneous other items.

Disclosure of interest and income taxes paid

The aggregate amount of interest paid for the years ended December 31, 2001 and 2000 was $163.3 and $182.0 respectively. The aggregate amount of income taxes paid for the years ended December 31, 2001 and 2000 was $31.6 and $4.5 respectively.

Future changes in United States accounting policies

The company is required to adopt for United States reporting purposes Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets". Under this standard, effective January 1, 2002, goodwill will no longer be amortized over its estimated useful life, however it will be assessed on an annual basis for impairment requiring writedowns. Similarly, the excess of net assets over purchase price paid will no longer be amortized to earnings but will be added to earnings through a cumulative catchup adjustment. The impact of these amortization changes would not be material to pre-tax earnings and there would be an increase in earnings for the cumulative catchup adjustment of $179.7. Giving effect to the elimination of negative goodwill at January 1, 2002, shareholders' equity based on US GAAP would be $2,554.7.

Management's Discussion and Analysis of Financial Condition and Results of Operations

(figures and amounts are in $ millions except per share amounts and as otherwise indicated)

Notes: (1) Readers of the Management's Discussion and Analysis of Financial Condition and Results of Operations should review the entire Annual Report for additional commentary and information.

(2) Management analyzes and assesses the underlying insurance and reinsurance operations and financial position of the consolidated group in various ways. Certain of these measures provided in this Annual Report, which have been used historically and disclosed regularly in Fairfax's Annual Reports and interim financial reporting, even though they do not necessarily follow Canadian generally accepted accounting principles, include tables showing the company's sources of net earnings with Lindsey Morden equity accounted, adjusted combined ratios, APH reserves and reinsurance recoverables excluding TRG and the company's capital structure with Lindsey Morden equity accounted. Where non-GAAP measures are provided, descriptions are clearly provided in the commentary as to the nature of the adjustments made.

Foreign Exchange

The company's consolidated financial statements are significantly affected by movements in the US dollar/Canadian dollar exchange rate. The following table sets out the Canadian dollar value of US$1.00 used in those statements:

(a)	Year end exchange rate	
	December 31, 2001	$1.5963
	December 31, 2000	$1.5020
	Increase in the value of the US dollar vs. the Canadian dollar	6.3%
(b)	Average exchange rate for the year	
	December 31, 2001	$1.5461
	December 31, 2000	$1.4839
	Increase in the value of the US dollar vs. the Canadian dollar	4.2%

Sources of Revenue

Revenue reflected in the consolidated financial statements includes net premiums earned, interest and dividend income and realized gains on the sale of investments of the insurance, reinsurance and runoff companies, and claims adjusting fees of Lindsey Morden.

Revenue by Line of Business

	2001	2000	1999	1998	1997
Net premiums earned					
Insurance – Canada	730.2	656.2	650.0	687.3	661.5
Insurance – U.S.	2,527.4	2,416.9	2,307.0	715.5	205.7
Reinsurance	1,392.3	1,224.3	1,275.2	992.1	593.4
Runoff	156.8	313.3	238.5	–	–
	4,806.7	4,610.7	4,470.7	2,394.9	1,460.6
Interest and dividends	680.8	818.1	753.0	443.8	254.6
Realized gains	213.5	382.8	121.7	440.8	206.8
Claims fees	424.7	376.9	443.1	294.8	166.3
	6,125.7	6,188.5	5,788.5	3,574.3	2,088.3

Net premiums earned for the U.S. insurance group were reduced by premiums ceded in the third quarter of 2001 under reinsurance protection on reserve strengthening for 2000 and prior accident years (Ceded Reinsurance Premiums) of $261.1. Total revenue for 2001, before Ceded Reinsurance Premiums, increased by $198 or 3.2% over 2000.

Claims fees for 2001 increased by $47.8 or 12.7% over 2000, reflecting higher revenue throughout Lindsey Morden's operations.

As shown in note 15 to the financial statements, on a geographic basis, United States, Canadian and Europe and Far East operations accounted for 75%, 14% and 11%, respectively, of net premiums earned in 2001 compared with 71%, 13% and 16%, respectively, in 2000.

Net Earnings

Combined ratios and sources of net earnings (with Lindsey Morden equity accounted) for the past five years were as set out below. Fuller commentary on combined ratios and on operating income on a company by company basis is provided below under the sub-headings Insurance Underwriting and Operating Income.

	Adjusted 2001*	2001	2000	1999	1998	1997
Combined ratios						
Insurance – Canada	111%	116%	102%	115%	106%	99%
– U.S.	114%	125%	124%	112%	116%	112%
Reinsurance	103%	115%	108%	119%	116%	106%
Consolidated	110%	121%	116%	115%	113%	104%

	Adjusted 2001*	2001	2000	1999	1998	1997
Sources of net earnings						
Underwriting						
Insurance						
Canada	(80.2)	(119.5)	(13.0)	(96.6)	(40.3)	5.2
U.S.	(384.8)	(637.9)	(588.4)	(273.1)	(116.5)	(25.6)
Reinsurance	(44.5)	(214.7)	(97.4)	(247.4)	(154.6)	(35.8)
Interest and dividends	491.7	491.7	593.5	711.5	432.0	242.3
Operating income (loss)	(17.8)	(480.4)	(105.3)	94.4	120.6	186.1
Realized gains		213.5	378.3	121.7	440.8	206.8
Runoff		(27.4)	43.3	(54.2)	–	–
Claims adjusting (Fairfax portion)		(3.9)	(15.4)	2.8	12.4	1.8
Interest expense		(155.2)	(164.7)	(129.3)	(84.4)	(43.2)
Goodwill and other amortization		(7.0)	(5.4)	(5.1)	(4.9)	(4.8)
Negative goodwill		78.6	108.7	–	–	–
Swiss Re premium		(143.6)	(167.2)	(35.3)	–	–
Kingsmead losses		(116.7)	(33.0)	–	–	–
Restructuring		(49.1)	(16.4)	–	–	–
Corporate overhead and other		(38.9)	(35.5)	(20.2)	(16.0)	(15.0)
Pre-tax income (loss)		(730.1)	(12.6)	(25.2)	468.5	331.7
Less (add): taxes		(382.5)	(173.3)	(158.0)	81.0	99.2
Less (add): non-controlling interests		(1.6)	23.3	8.6	–	–
Net earnings (loss)		(346.0)	137.4	124.2	387.5	232.5

* *Excluding the impact of catastrophe losses (World Trade Center, Enron and Tropical Storm Allison) and prior years' reserve strengthening for the U.S. insurance group.*

Net loss in 2001 was $346.0 compared with net earnings of $137.4 in 2000. The pre-tax loss in 2001 was $730.1 compared with $12.6 in 2000. The 2001 loss was primarily caused by:

- World Trade Center losses of $288.3;
- 2000 and prior years' reserve strengthening by the U.S. insurance companies of $304;
- Kingsmead losses, excluding those related to the World Trade Center, of $54.3; and
- restructuring costs of $49.1.

World Trade Center Losses

Fairfax incurred the following losses from the September 11th terrorist attacks on the World Trade Center:

	Net loss	
	$	US$
Commonwealth	25.8	16.7
Crum & Forster	22.5	14.6
TIG	16.7	10.8
OdysseyRe	147.1	95.3
Kingsmead	62.4	40.4
Others	13.8	9.0
Total Fairfax	288.3	186.8
OdysseyRe non-controlling interest	(38.3)	(24.8)
Pre-tax impact	250.0	162.0
After tax impact	162.5	105.3

At December 31, 2001, the gross World Trade Center loss amounted to $1,280 (US$802), and the aggregate related reinsurance recoverable amounted to $992 (US$615). As shown in the following table, 95% of the reinsurance recoverable is from reinsurers rated A or higher.

	US$	% of total
AAA	118.8	19.3
AA	139.0	22.6
A	326.3	53.1
Total A or higher	584.1	95.0
BBB or lower and unrated	30.9	5.0
	615.0	100.0

In the fourth quarter of 2001, OdysseyRe also recorded a provision of $23 (US$15) related to its reinsurance exposure to Enron. Fairfax has no other underwriting or investment exposure to Enron.

2000 and Prior Years' Reserve Strengthening

In 2001, the U.S. insurance companies strengthened 2000 and prior accident years' claims reserves reflecting unexpected claims development from pre-acquisition claims reserves and from the post-acquisition transition period when new management significantly changed underwriting and claims handling practices and controls.

Crum & Forster recorded gross reserve strengthening for 2000 and prior accident years of $618 (US$400). Of the total, $186 (US$120) was for the 1999 accident year, $73 (US$47) was for the 2000 accident year and the balance was related to the 1998 and prior accident years (including a $294 (US$190) cession to fully utilize the vendor-provided reinsurance protection against pre-acquisition adverse claims development and unrecoverable reinsurance). The net

pre-tax cost of the aggregate reinsurance protection for this 2000 and prior accident years' reserve strengthening was $114 (US$74).

TIG recorded gross reserve strengthening for 2000 and prior accident years of $325 (US$210), of which $123 (US$80) was for the 1999 accident year, $180 (US$116) was for the 2000 accident year and $22 (US$14) was for unallocated loss adjustment expenses. The net pre-tax cost of the aggregate reinsurance protection for, and retained losses from, this 2000 and prior accident years' reserve strengthening was $190 (US$123).

Ranger recorded gross and net reserve strengthening for 2000 and prior accident years of $63 (US$41), primarily relating to construction defect claims under its California Artisan Contractors' program (discontinued in March 2000) and to its assumed reinsurance program (discontinued in 1985).

Insurance Underwriting

The combined loss and expense ratio is the traditional measure of underwriting results of property and casualty companies. In any year when the ratio exceeds 100%, it generally indicates that unprofitable business has been underwritten. Fairfax maintains its objective of achieving combined ratios of 100% or better, recognizing the difficulty of this objective.

A summary follows of the net premiums written and earned, and the loss, expense and combined ratios, for Fairfax's Canadian insurance companies, U.S. insurance companies and reinsurance companies, for the years respectively that Fairfax has owned those companies.

Canadian Insurance

	NET PREMIUMS		RATIOS		
	Written	Earned	Loss (%)	Expense (%)	Combined (%)
1985	23.4	14.0	96	30	126
1986	56.0	40.9	72	23	95
1987	71.4	62.0	73	25	98
1988	68.2	66.3	73	19	92
1989	35.5	40.4	100	40	140
1990	74.5	78.4	82	31	113
1991	93.5	90.5	60	34	94
1992	128.7	118.9	79	35	114
1993	163.5	150.8	73	26	99
1994	237.2	221.3	77	24	101
1995	684.3	655.4	73	29	102
1996	666.9	654.8	71	30	101
1997	662.7	661.5	70	29	99
1998	684.2	687.3	78	28	106
1999	652.4	650.0	83	32	115
2000	668.8	656.2	72	30	102
2001	875.1	730.2	85	31	116*

* *111% excluding the impact of catastrophe losses (World Trade Center and Tropical Storm Allison)*

U.S. Insurance

	NET PREMIUMS		RATIOS		
	Written	Earned	Loss (%)	Expense (%)	Combined (%)
1994	174.4	179.3	77	37	114
1995	180.3	173.9	79	40	119
1996	212.8	209.4	90	34	124
1997	201.9	205.7	77	35	112
1998	625.9	715.5	79	37	116
1999	2,093.2	2,307.0	75	37	112
2000	2,443.4	2,416.9	89	35	124
2001	2,515.2	2,527.4	86	39	125*

* *114% excluding the impact of catastrophe losses (World Trade Center and Tropical Storm Allison) and prior years' reserve strengthening*

Reinsurance

	NET PREMIUMS		RATIOS		
	Written	Earned	Loss (%)	Expense (%)	Combined (%)
1996	163.4	166.7	62	34	96
1997	527.9	593.4	72	34	106
1998	966.5	992.1	80	36	116
1999	1,276.9	1,275.2	85	34	119
2000	1,222.9	1,224.3	71	37	108
2001	1,483.7	1,392.3	81	34	115*

* *103% excluding the impact of catastrophe losses (World Trade Center and Enron)*

Operating Income

Set out and discussed below are the 2001 insurance underwriting and operating results of Fairfax's insurance and reinsurance companies on a summarized company by company basis. (Throughout this Annual Report, for convenience, Falcon is included under U.S. insurance companies.)

Canadian Insurance Companies

	Commonwealth	Federated	Lombard	Markel	Corporate adjustments	Total
Underwriting profit (loss)	**(58.8)**	**(2.0)**	**(76.4)**	**0.4**	**17.3(1)**	**(119.5)**
Adjusted underwriting profit (loss)(2)	(21.2)	(2.0)	(74.7)	0.4	17.3(1)	(80.2)
Combined ratio:						
Loss & LAE	140.4%	73.5%	81.1%	71.2%		84.7%
Commissions	0.9%	5.4%	19.0%	5.1%		14.0%
Underwriting expense	21.3%	23.9%	15.2%	23.1%		17.7%
	162.6%	102.8%	115.3%	99.4%		116.4%
Adjusted combined ratio(2)	122.6%	102.8%	115.0%	99.4%		111.0%
Gross premiums written	374.9	92.6	612.7	103.9		1,184.1
Net premiums written	176.4	76.3	547.1	75.3		875.1
Net premiums earned	94.0	70.6	498.5	67.1		730.2
Underwriting profit (loss)	(58.8)	(2.0)	(76.4)	0.4	17.3(1)	(119.5)
Interest and dividends						64.7
Operating income (loss)						(54.8)

(1) Swiss Re recovery on 1998 and prior losses, as described in more detail under Swiss Re premium on page 58

(2) Excluding the impact of catastrophe losses (World Trade Center and Tropical Storm Allison)

Commonwealth had an adjusted underwriting loss of $21.2 in 2001 compared with $3.7 in 2000 and an adjusted combined ratio of 122.6% in 2001 compared with 105.5% in 2000, reflecting unexpected and unusual losses in its property book and adverse, but steadily improving, results in its energy book. Gross premiums written increased by 76% over 2000 to $374.9 while net premiums written increased by 121% to $176.4. Commonwealth's expense ratio dropped by 2.8 percentage points to 22.2% reflecting its higher net premiums earned in 2001. The company achieved significant price increases on its business in 2001, which will be realized in earned premiums in 2002. Commonwealth will be retaining more of its own business in 2002, and its combined ratio is expected to improve significantly in 2002 as a result of the pricing and underwriting actions taken in 2001.

Federated had an underwriting loss of $2.0 in 2001 compared with $4.6 in 2000 and improved its combined ratio to 102.8% in 2001 from 106.5% in 2000 (including the life company). Federated's property and casualty gross premiums written increased by 12% to $72.7 in 2001 while its net premiums written increased by 5% to $59.0. Federated maintained its expense ratio below 30%. Federated Life had gross premiums written of $19.9, an increase of 8% from 2000. The company achieved a 24% rate increase during 2001, has continued re-underwriting its book of business and will be retaining more of its own business in 2002. With a high 90% retention ratio, Federated is on track to have a combined ratio below 100% in 2002.

Lombard had an adjusted underwriting loss of $74.7 in 2001 compared with $2.7 in 2000 and an adjusted combined ratio of 115.0% in 2001 compared with 100.6% in 2000, due to winter weather-related and crop hail losses, adverse development on discontinued extended warranty programs as well as disappointing results from its personal lines book. Excluding prior years' adverse development and crop hail losses, Lombard's adjusted combined ratio in 2001 was 104.9%. Lombard's gross premiums written (including cessions to CRC (Bermuda)) increased 22% to $612.7 in 2001 while net premiums written (on the same basis) were up 23% to $547.1. Significant corrective action has been taken including cancellation of unprofitable books and programs, more stringent underwriting and price increases in excess of 10% in its commercial lines, with more modest increases in its personal lines. Lombard will be retaining more of its own business in 2002, and its combined ratio is expected to improve significantly in 2002.

Markel produced a combined ratio of 99.4% in 2001, a year that saw disastrous performance for writers of long-haul trucking insurance in Canada and the U.S., with combined ratios estimated as high as 180%. Celebrating its 50th year serving the transportation industry in 2001, Markel, under the guidance of Mark Ram and his team, has built a highly successful business approach for this historically difficult class of business. Claims satisfaction and account retention ratios at Markel have both run consistently above 90%, an indication of the company's expertise and commitment to providing excellent value to its customers. Without the significant investment in highly experienced underwriting, claims, safety and training teams, each the largest of its type in Canada, Markel's performance, and its reputation for offering unique products and services, would not be possible. Gross premiums written in 2001 were $103.9 million, an increase of 17%, while net premiums written grew to $75.3 million, up 16% from 2000.

U.S. Insurance Companies

	Crum & Forster	Ranger	TIG	Falcon	Corporate adjustments	Total
Underwriting profit (loss)	**(245.0)**	**(81.7)**	**(456.8)**	**(4.0)**	**149.6[1]**	**(637.9)**
Adjusted underwriting profit (loss)[2]	(87.6)	(20.5)	(272.7)	(4.0)		(384.8)
Combined ratio:						
Loss & LAE	88.6%	136.0%	90.0%	76.8%		85.4%
Commissions	13.9%	21.1%	22.9%	12.8%		20.0%
Underwriting expense	28.6%	25.8%	15.2%	35.6%		19.9%
	131.1%	182.9%	128.1%	125.2%		125.3%
Adjusted combined ratio[2]	109.0%	120.8%	116.0%	125.2%		113.8%
Gross premiums written	1,295.5	128.5	2,239.6	33.7		3,697.3
Net premiums written	801.9	111.9	1,583.0	18.4		2,515.2
Net premiums earned	787.2	98.5	1,625.8	15.9		2,527.4
Underwriting profit (loss)	(245.0)	(81.7)	(456.8)	(4.0)	149.6[1]	(637.9)
Interest and dividends						249.8
Operating income (loss)						(388.1)

(1) Swiss Re recovery on 1998 and prior losses, as described in more detail under Swiss Re premium on page 58

(2) Excluding the impact of catastrophe losses (World Trade Center, Enron and Tropical Storm Allison) and prior years' reserve strengthening

Crum & Forster had an adjusted underwriting loss of $87.6 in 2001 compared with $197.9 in 2000, and an adjusted combined ratio of 109.0% compared with a fully developed 2000 accident year combined ratio of 116.8%, reflecting double digit price increases in 2000 and 2001 and management's re-underwriting actions. Crum & Forster's gross premiums written in 2001 increased by 28% to $1,295.5 while net premiums written (before ceded reinsurance premiums of $185.8 in connection with reserve strengthening) increased 40% to $987.7 principally due to price increases realized during 2001 and the impact of the higher U.S. dollar/ Canadian dollar exchange rate during the year. The retention ratio of 44% during 2001 reflected continuing re-underwriting of the business, including the push for additional price increases during the year. Excluding Seneca, new business premium in 2001 was up 116% to US$368.8 from US$170.7 in 2000.

Ranger had an adjusted underwriting loss of $20.5 in 2001 compared with $47.6 in 2000, and an adjusted combined ratio of 120.8% compared with a fully developed 2000 accident year combined ratio of 121.6%, reflecting Ranger's continued extremely high expense ratio (including commissions) of 46.9% due to a 47% decrease in premiums written from 1999 to 2000. The company continues to manage its expenses aggressively. Ranger's gross premiums written in 2001 increased 11% to $128.5 from $115.7 in 2000, principally due to price increases realized during 2001 and the impact of the higher U.S. dollar/Canadian dollar exchange rate during 2001. Its net premiums written in 2001 increased 60% to $111.9 from $69.7, reflecting increased retentions and lower reinsurance costs in 2001. As net premiums earned increase in 2002 reflecting the benefit of double digit price increases in 2001 (continuing in 2002), the expense ratio should decrease, and this along with price increases, focused underwriting and higher retentions should result in a significantly improved combined ratio in 2002.

TIG's adjusted underwriting loss in 2001 was $272.7 compared with $345.9 in 2000, and its adjusted combined ratio was 116.0% compared with a fully developed 2000 accident year combined ratio of 129.4%, reflecting double digit price increases achieved starting in the third quarter of 2000 and management's strengthening of claims and underwriting controls since 1999, the effect of which is emerging at a slower pace than expected. TIG's gross premiums written in 2001 were $2,239.6, an increase of 9% from $2,046.9 in 2000. Net premiums written (before ceded reinsurance premiums of $75.3 in connection with reserve strengthening) increased 14.2% to $1,658.3.

Falcon had an underwriting loss of $4.0 in 2001 compared with $6.6 in 2000 and had a combined ratio of 125.2% in 2001 compared with 173.4% in 2000. A principal component of Falcon's high combined ratio was its expense ratio of 48.4% (including a commission rate of 12.8%) reflecting its transition from a startup in 1999. Net premiums written in 2001 increased by 37% to $18.4 (HK$90.7) from $12.6 (HK$66.1) in 2000. The acquisition of Winterthur (Asia)

in December 2001, referred to on page 80, should address Falcon's expense structure as it targets a 100% combined ratio in 2002.

Reinsurance

	OdysseyRe(1)
Underwriting profit (loss)	**(214.7)**
Adjusted underwriting profit (loss)(2)	(44.5)
Combined ratio:	
Loss & LAE	80.6%
Commissions	27.6%
Underwriting expense	7.2%
	115.4%
Adjusted combined ratio(2)	103.1%
Gross premiums written	1,731.5
Net premiums written	1,483.7
Net premiums earned	1,392.3
Underwriting profit (loss)	(214.7)
Interest and dividends	176.1
Operating income (loss)	(38.6)

(1) *These results differ from those published by Odyssey Re Holdings Corp. (ORH) due to the elimination of intercompany transactions and purchase price and other adjustments made as part of ORH's IPO.*

(2) *Excluding the impact of catastrophe losses (World Trade Center, Enron and Tropical Storm Allison)*

OdysseyRe had an adjusted underwriting loss of $44.5 in 2001 compared with $97.4 in 2000 and an adjusted combined ratio of 103.1% in 2001 compared to 108.0% in 2000, representing substantial improvements in 2001 over its 2000 results. Net premiums written increased by 21% in 2001 to $1,483.7 from $1,222.9 in 2000, reflecting price increases achieved in 2001 and the impact of the higher U.S. dollar/Canadian dollar exchange rate during the year. Given the increase in underlying insurance rates and the higher reinsurance pricing experienced in 2001 and expected for 2002, OdysseyRe is well positioned to achieve its objective of a 100% combined ratio in 2002.

Interest and Dividends

Interest and dividends declined by $101.8 from $593.5 in 2000 to $491.7 in 2001 reflecting primarily:

- a $0.8 billion decrease in the average investment portfolios of the insurance and reinsurance companies in 2001 due to the significant reduction in Crum & Forster's net premiums earned which declined from US$933.7 in 1997 (the year before Fairfax's

acquisition) to a low of US$548.0 in 2000 and a significant reduction in the net premiums written of Odyssey America Re (formerly TIG Re) of US$100.0 from 1997 to 1999 as it exited the reverse flow and facultative business;

- an increase in funds withheld interest expense from $102.4 in 2000 to $146.3 in 2001, reflecting the stop loss treaties at Crum & Forster, TIG and OdysseyRe and Fairfax's Swiss Re cover described under Funds withheld payable to reinsurers on page 61; and
- lower interest rates prevailing in 2001.

Other Components of Net Earnings

Realized gains. Net realized gains (excluding a realized gain on the OdysseyRe IPO of $51.2 in 2001) decreased in 2001 to $162.3 from $378.3 in 2000. The 2001 realized gains resulted from put contracts on a basket of technology stocks, as well as from S&P500 Index puts and the sale of individual common stocks and bonds.

On June 14, 2001, Odyssey Re Holdings Corp. (ORH), the U.S. holding company for Odyssey America Re and its subsidiaries, issued 17,142,857 common shares, in an initial public offering, at US$18 per share for net proceeds (after expenses of issue) of $436.9 (US$284.8). Fairfax and its wholly-owned subsidiary, TIG Specialty Insurance, received $354.4 (US$233.5) in cash from these proceeds. Fairfax recorded a $51.2 gain on this transaction, which constituted an effective sale of a 26.3% interest in ORH.

After the offering, Fairfax and TIG held 48 million (73.7%) of ORH's common shares and a $303.5 (US$200) ORH three year term note bearing interest at the rate of 2.25% over LIBOR and repayable by annual principal payments of US$66.7 beginning June 30, 2002. Based on the IPO price of US$18 per share, the value of the company's 48 million common shares, the term note of ORH and the cash proceeds received from the IPO amounted to $2 billion (US$1.3 billion).

Runoff. The runoff business segment was formed with the acquisition of the company's interest in The Resolution Group (TRG) and its wholly-owned subsidiary, International Insurance, on August 11, 1999.

Fairfax purchased 100% of TRG's voting common shares for US$97 which represents an effective 27.5% economic interest in TRG's results of operations and net assets. Xerox retains all of TRG's participating non-voting preferred shares, resulting in an effective 72.5% economic interest in TRG's results of operations and net assets. Xerox's wholly-owned subsidiary, Ridge Re, also provides TRG's wholly-owned subsidiary, International Insurance, with the vendor indemnity (unutilized coverage of $186 (US$116) at December 31, 2001) referred to under Additional Reinsurance Protection on page 79. International Insurance's cessions to Ridge Re are fully collateralized by trust funds in the same amount as the cessions. As agreed in connection with Fairfax's purchase of its interest in TRG, TRG is maintained as a distinct company for its common and preferred shareholders and cannot engage in transactions with other Fairfax subsidiaries. Accordingly, TRG is considered to be a financial investment and Fairfax's exposure to loss (regardless of the results of International Insurance) is limited to its US$97 investment.

The runoff segment also includes the company's European runoff operations, consisting of Sphere Drake, which was transferred to runoff effective July 1, 1999, RiverStone Stockholm, a runoff company purchased in September 1998, and CTR's non-life reinsurance business, which is included in the runoff segment as effective January 1, 2001, CTR's non-life reinsurance new and renewal business was written by the Euro-Asia division of OdysseyRe. (CTR continues to write a small portfolio of life reinsurance business.) ORC Re reinsures the reinsurance portfolios of the European runoff operations to provide consolidated investment and liquidity management services, with the RiverStone Group retaining full responsibility for all other aspects of the runoff. Accordingly, for operating segment purposes, ORC Re is classified in the runoff segment.

Set out below is a summary of 2001 operating results:

	TRG	**European runoff**	**Total**
Gross premiums written	0.4	78.9	79.3
Net premiums written	0.4	43.3	43.7
Net premiums earned	0.4	156.4	156.8
Losses on claims	(15.6)	(207.3)[(1)]	(222.9)
Operating expenses	(21.0)	(107.4)	(128.4)
Interest and dividends	66.4	100.7	167.1
Operating income (loss)	30.2	(57.6)	(27.4)

(1) Net of Swiss Re recovery of $121.1 on 1998 and prior losses, as described in more detail under Swiss Re premium below on this page, the benefit of which has been indirectly provided to ORC Re

The loss of $27.4 resulted primarily from claims handling costs and Sphere Drake's reserve strengthening for 1996 and subsequent losses referred to on page 72, net of the protection provided by the company's Swiss Re cover, in excess of interest and dividend income.

Claims adjusting. Fairfax's $3.9 share of Lindsey Morden's loss in 2001, compared with a $15.4 share of the loss in 2000, reflects Lindsey Morden's significantly higher revenue throughout its operations and substantially improved operating profit (reflecting cost reductions) from its Canada, U.S. and U.K. operations, as well as an absence of non-recurring items.

Interest expense. Interest expense decreased in 2001 due to the benefit of the company's interest rate swaps offset by the higher U.S. dollar/Canadian dollar exchange rate and the external issuance of OdysseyRe's debt in the fourth quarter of 2001. Under its interest rate swaps, the company receives the fixed coupon interest rate on its swapped debt and pays interest at floating interest rates based on LIBOR. The benefit of these swaps amounted to $26.6 or 153 basis points in 2001 compared to 69 basis points in 2000.

Swiss Re premium. As part of its acquisition of TIG effective April 13, 1999, Fairfax purchased a US$1 billion corporate insurance cover from Swiss Re (Swiss Re Cover) protecting it from adverse development in claims and unrecoverable reinsurance above the reserves set up by all of its subsidiaries (including TIG Specialty Insurance and Odyssey America Re (formerly

TIG Re) but not including other subsidiaries acquired after 1998) at December 31, 1998. With the OdysseyRe IPO, effective June 14, 2001 Odyssey America Re's and Odyssey Reinsurance Corporation's claims and unrecoverable reinsurance were no longer protected by the Swiss Re Cover.

In 2001, Fairfax strengthened 1998 and prior reserves and ceded these losses of $315.1 (US$203.8) to Swiss Re for which it will pay an additional premium of $143.6 (US$92.9) to a funds withheld account to the benefit of Swiss Re. Ownership of the investments in the funds withheld account remains with Fairfax. The cessions by operating segment for 2001 and 2000 were as follows:

	2001	**2000**
Canadian insurance	17.3	(14.4)
U.S. insurance	149.6	247.5
Reinsurance	–	33.7
Runoff	121.1	131.8
Kingsmead	27.1	5.9
Total	315.1	404.5

The Swiss Re premium cost was $143.6 for 2001 compared with $167.2 for 2000 reflecting lower cessions but a higher premium rate.

The premium payable of $97.2 in respect of losses ceded to September 30, 2001 was paid in the first quarter of 2002 with the balance of the Swiss Re premium of $46.4 payable in the second quarter of 2002. Additional premium will be payable to Swiss Re if additional losses are ceded to this cover in future years.

Kingsmead losses. At the time of the acquisition of TIG, TIG Specialty Insurance had a 90% ownership in Kingsmead Managing Agency, a managing agent for three Lloyd's syndicates for which TIG provided underwriting capacity of £151.4 for 2000. In the fourth quarter of 2000, Fairfax sold its investment in Kingsmead to Advent Capital plc but retained liability for the 2000 and prior underwriting years' liabilities until those years are closed in accordance with Lloyd's requirements. The Kingsmead loss of $116.7 in 2001 reflects World Trade Center net losses of $62.4 (US$40.4) from unexpired policies from the 2000 underwriting year and adverse development (net of the Swiss Re recovery referred to above) of $54.3 from 2000 and prior open underwriting years for which the company remains responsible.

Restructuring. The restructuring costs of $49.1 in 2001 are comprised of:

- a termination fee of $13.4 on the cancellation of TIG's computer services contract with a third party as part of the company's strategy to realize significant cost savings over the next three years by building a common U.S. insurance group systems platform;
- TIG's costs of closing certain offices and related severances ($19.3); and
- TIG's costs of insourcing claims from third party administrators and terminating managing general agent relationships ($16.4).

Corporate overhead and other. Corporate overhead and other consists of holding company expenses net of Hamblin Watsa's pre-tax income and interest income on Fairfax's cash balances, as set out in more detail in the combined holding company statement of earnings on page 101.

Taxes. The company recorded a recovery for income taxes in 2001 due to income earned outside Canada at lower rates of tax and operating losses in higher tax rate jurisdictions as summarized in the income tax rate reconciliation table in note 9 to the financial statements.

Non-controlling interests. The non-controlling interests represent the 33.5% public minority interest in Lindsey Morden, Xerox's effective 72.5% economic interest in TRG and the 26.3% public minority interest in OdysseyRe since its IPO on June 14, 2001.

Balance Sheet Analysis

Cash and short term investments and **Marketable securities** consist of the holding company's cash deposits and short term investments which it maintains as a safety net to ensure that it can cover its debt service and operating requirements for some years even if its insurance subsidiaries pay no dividends (see the discussion on page 86). Cash and short term investments consist of the company's bank operating account, overnight bank deposits and investments in short term government treasury bills. Marketable securities include the company's investment in S&P500 Index put contracts ($67.7).

Accounts receivable and other consists of premiums receivable (net of provisions for uncollectible amounts) of $2.3 billion, funds withheld receivables from cedants and other reinsurance balances of $546, accrued interest of $149, prepaid expenses of $153 and other accounts receivable of $257.

Recoverable from reinsurers consists of future recoveries on unpaid claims ($11.4 billion), reinsurance receivable on paid losses ($1.0 billion) and unearned premiums from reinsurers ($402). Please see Reinsurance Recoverables beginning on page 75 for a detailed discussion of amounts recoverable from reinsurers.

Investments in Hub and Zenith National represent Fairfax's investment in 37%-owned Hub International Limited ($128) and 42%-owned Zenith National Insurance Corp. ($343), both of which are publicly listed companies (the combined market value of these investments was $525 at December 31, 2001).

Deferred premium acquisition costs (DPAC) consist of brokers' commissions and premium taxes. These are deferred, together with the related unearned premiums (UPR), and amortized to income over the term of the underlying insurance policies. Unlike many companies in the insurance industry, the company does not defer internal underwriting costs as part of DPAC and the recoverability of DPAC is determined without giving credit to investment income. The ratio of DPAC to UPR (19.6% at December 31, 2001) varies from time to time depending on the mix of business being written and the estimated recoverability of DPAC given expected loss ratios on the UPR.

Future income taxes represent amounts expected to be recovered in future years. At December 31, 2001 future income taxes consisted of $1,123 of capitalized operating and capital

losses ($1,182 gross less a valuation allowance of $59), and timing differences of $596 which represent expenses recorded in the financial statements but not yet deducted for income tax purposes. The capitalized operating losses relate primarily to the U.S. companies ($944, including $430 arising on the acquisition of TIG in 1999), where 80% of the losses expire between 2020 and 2022, the Canadian holding company ($88), Sphere Drake ($35) and CTR ($21). The company expects to realize the benefit of these capitalized losses from future profitable operations during the loss carryforward period. The valuation allowance recognizes the uncertainty in realizing the benefit of certain of the operating losses depending on the jurisdiction and on the time limit before the losses expire. In determining the need for a valuation allowance, management considers the progress being made to achieve underwriting profitability, including achieved premium rate increases, additional reinsurance protection and the elimination of poor performing business. For recent acquisitions, such as CFI and TIG, pre-acquisition history is not considered representative of future results. Management reviews the recoverability of the future tax asset and the valuation allowance on an ongoing basis. The timing differences principally relate to insurance-related balances such as claims, DPAC and UPR; such timing differences are expected to continue for the foreseeable future in light of the company's ongoing operations.

Goodwill arises on the acquisition of companies where the purchase price paid exceeds the fair value of the underlying net tangible assets acquired. Goodwill at December 31, 2001 arises from Lindsey Morden ($231), Lombard's acquisition of brokers ($21), Crum & Forster's acquisition of Seneca and Transnational in 2000 ($12), Falcon ($6), Ranger ($2) and Hamblin Watsa ($2). Lindsey Morden's goodwill is amortized to income on a straight line basis over 40 years while the other companies' goodwill is amortized to income on a straight line basis over ten years. In accordance with changes in Canadian accounting standards, effective January 1, 2002 goodwill will no longer be amortized to earnings but will be subject to writeoff if and when it is determined that an impairment in value exists.

Other assets include loans receivable and shares held in connection with the company's management share purchase and restricted stock grant programs and miscellaneous other balances.

Accounts payable and accrued liabilities include employee related liabilities, amounts due to brokers and agents including contingent commissions, liabilities for operating expenses incurred in the normal course of business, dividends payable to policyholders, salvage and subrogation payable and other similar balances.

Funds withheld payable to reinsurers represent premiums and accumulated accrued interest (at rates ranging from 5.75% to 8.0% per annum) on aggregate stop loss reinsurance treaties, principally relating to OdysseyRe ($487), Fairfax's corporate insurance cover with Swiss Re ($474), Crum & Forster ($407) and TIG ($353). The companies retain ownership of the underlying investments, but the interest earned on those investments accrues to the reinsurers. Claims payable under such treaties are paid first out of the funds withheld payable balances.

Provision for claims consists of the gross amount of individual case reserves established by the insurance companies, individual case estimates reported by ceding companies to the reinsurance companies and management's estimate of claims incurred but not reported

(IBNR) based on the volume of business currently in force and the historical experience on claims. Please see Provision for Claims beginning below on this page for a detailed discussion of the company's provision for claims.

Unearned premiums are described above under Deferred premium acquisition costs.

Non-controlling interests represent the minority shareholders' 72.5% share of the underlying net assets of TRG ($612), 26.3% share of the underlying net assets of OdysseyRe ($362) and 33.5% share of the underlying net assets of Lindsey Morden ($69). All of the assets and liabilities, including long term debt, of these companies are included in the company's consolidated balance sheet.

Excess of net assets acquired over purchase price paid (negative goodwill) represents the aggregate unamortized amount of such excess, which arose as a result of the company's acquisition of certain companies at prices less than the fair value of the underlying net tangible assets acquired. In accordance with changes in Canadian accounting standards, the balance of negative goodwill of $51.4 will be added to the company's retained earnings as of January 1, 2002.

Provision for Claims

Claim provisions are established by the case method as claims are reported. The provisions are subsequently adjusted as additional information on the estimated amount of a claim becomes known during the course of its settlement. A provision is also made for management's calculation of factors affecting the future development of claims including IBNR based on the volume of business currently in force and the historical experience on claims.

As time passes, more information about the claims becomes known and provision estimates are appropriately adjusted upward or downward. Because of the estimation elements encompassed in this process, and the time it takes to settle many of the more substantial claims, several years are required before a meaningful comparison of actual losses to the original provisions can be developed.

The development of the provision for claims is shown by the difference between estimates of reserves as of the initial year-end and the re-estimated liability at each subsequent year-end. This is based on actual payments in full or partial settlement of claims, plus re-estimates of the reserves required for claims still open or claims still unreported. Unfavourable development means that the original reserve estimates were lower than subsequently indicated.

The following table presents a reconciliation of the provision for claims and loss adjustment expense (LAE) for the insurance, reinsurance and runoff lines of business for the past five years. As shown in the table, the sum of the provision for claims for all of Fairfax's insurance, reinsurance and runoff subsidiaries is $22,085.8 as at December 31, 2001 – the amount shown as Provision for claims on Fairfax's consolidated balance sheet on page 25. The Other shown in the following table was the $14 Fairfax indemnification of Ranger reserves.

Reconciliation of Provision for Claims and LAE as at December 31

	2001	2000	1999	1998	1997
Insurance subsidiaries owned throughout the year – net of indemnification	5,603.8	5,538.5	4,258.2	1,107.6	978.5
Insurance subsidiaries acquired during the year	25.7	71.4	1,187.2	3,802.8	–
Total insurance subsidiaries	5,629.5	5,609.9	5,445.4	4,910.4	978.5
Reinsurance subsidiaries owned throughout the year	3,356.7	3,641.3	2,732.9	2,981.6	1,215.1
Reinsurance subsidiaries acquired during the year	–	–	1,394.9	1,362.3	1,869.5
Total reinsurance subsidiaries	3,356.7	3,641.3	4,127.8	4,343.9	3,084.6
Runoff subsidiaries owned throughout the year	2,448.6	2,307.7	1,733.0	–	–
Runoff subsidiaries acquired during the year	–	–	873.3	–	–
Total runoff subsidiaries	2,448.6	2,307.7	2,606.3	–	–
Federated Life	29.4	30.7	28.5	26.7	24.6
Other	–	–	–	14.0	14.0
Total provision for claims and LAE	11,464.2	11,589.6	12,208.0	9,295.0	4,101.7
Reinsurance gross-up	10,621.6	8,636.2	8,234.2	3,866.2	2,221.0
Total including gross-up	22,085.8	20,225.8	20,442.2	13,161.2	6,322.7

The seven tables that follow show the reconciliation and the reserve development of the insurance (Canadian and U.S.), reinsurance and runoff subsidiaries' provision for claims, before the company's US$1 billion corporate insurance cover from Swiss Re. Cessions to the Swiss Re corporate cover by group for 2001 and 2000 are set out under Swiss Re premium on page 58. Because business is written in various locations, there will necessarily be some distortions caused by foreign exchange fluctuations. The insurance subsidiaries' tables are presented in Canadian dollars for the Canadian subsidiaries and in U.S. dollars for the U.S. subsidiaries (as noted previously, Falcon is included with the U.S. insurance subsidiaries for convenience). The reinsurance and runoff subsidiaries' tables are presented in U.S. dollars as the reinsurance and runoff businesses are substantially transacted in that currency.

Canadian Insurance Subsidiaries

The following table shows for Fairfax's Canadian insurance subsidiaries the provision for claims liability for unpaid losses and LAE as originally and as currently estimated for the years 1997 through 2001. The favourable or unfavourable development from prior years is credited or charged to each year's earnings.

Reconciliation of Provision for Claims –
Canadian Insurance Subsidiaries

	2001	2000	1999	1998	1997
Provision for claims and LAE at January 1	896.1	890.4	818.8	764.0	746.1
Incurred losses on claims and LAE					
Provision for current accident year's claims	537.3	502.8	561.0	545.3	553.9
Increase (decrease) in provision for prior accident years' claims	43.6	(17.1)	(8.0)	(2.5)	(12.0)
Total incurred losses on claims and LAE	580.9	485.7	553.0	542.8	541.9
Payments for losses on claims and LAE					
Payments on current accident year's claims	(245.5)	(215.0)	(231.0)	(239.4)	(285.1)
Payments on prior accident years' claims	(296.7)	(265.0)	(250.4)	(248.6)	(238.9)
Total payments for losses on claims and LAE	(542.2)	(480.0)	(481.4)	(488.0)	(524.0)
Provision for claims and LAE at December 31	934.8	896.1	890.4	818.8	764.0

The company strives to establish adequate provisions at the original valuation date. It is the company's objective to have favourable development from the past. The reserves will always be subject to upward or downward development in the future.

The following table shows for Fairfax's Canadian insurance subsidiaries the original provision for claims reserves including LAE at each calendar year-end commencing in 1991 with the subsequent cumulative payments made from these years and the subsequent re-estimated amount of these reserves. The following Canadian insurance subsidiaries' reserves are included from the respective years in which such subsidiaries were acquired:

	Year Acquired
Markel	1985
Federated	1990
Commonwealth	1990
Lombard (including CRC (Bermuda))	1994

Provision for Canadian Insurance Subsidiaries' Claims Reserve Development

As at December 31	**1991 and prior**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
Provision for claims including LAE	168.4	179.6	185.0	673.8	695.3	746.1	764.0	818.8	890.4	896.1	934.8
Cumulative payments as of:											
One year later	48.1	56.8	63.0	233.8	219.9	238.9	248.6	250.4	265.0	296.7	
Two years later	75.4	87.9	105.5	351.6	355.0	386.4	392.7	409.9	439.6		
Three years later	94.8	110.6	127.4	457.7	455.3	494.0	504.8	536.7			
Four years later	110.8	126.1	147.3	525.5	532.0	577.1	588.6				
Five years later	120.4	137.7	159.5	577.5	585.8	633.4					
Six years later	128.1	146.0	166.0	612.7	628.0						
Seven years later	134.5	150.6	170.9	645.7							
Eight years later	138.3	154.1	175.0								
Nine years later	141.3	157.7									
Ten years later	144.1										
Reserves re-estimated as of:											
One year later	168.0	179.9	187.8	677.9	678.6	734.1	761.6	810.8	873.3	939.7	
Two years later	157.8	174.8	191.8	676.8	692.9	743.4	758.6	808.3	902.5		
Three years later	157.7	171.8	197.8	685.7	704.4	748.5	757.0	833.8			
Four years later	156.3	177.5	198.7	688.8	707.1	750.2	780.5				
Five years later	158.4	177.4	199.3	695.9	705.7	764.6					
Six years later	161.1	178.0	197.7	694.5	718.1						
Seven years later	162.5	175.9	198.8	709.7							
Eight years later	160.6	178.0	198.7								
Nine years later	161.9	177.4									
Ten years later	162.0										
Favourable (unfavourable) development	6.4	2.2	(13.7)	(35.9)	(22.8)	(18.5)	(16.5)	(15.0)	(12.1)	(43.6)	

The Canadian insurance subsidiaries had unfavourable development of $43.6 during 2001, relating to the unfavourable impact of foreign exchange on U.S. dollar claims affecting all years ($12.9), adverse development on the 1994 and prior years at Lombard ($14.9), adverse development on Lombard's discontinued extended warranty programs affecting the 1996 to 1998 years ($12.0), and adverse development on the 2000 year at Commonwealth in its U.S. property and energy books ($5.3) and at Lombard in its property book ($7.4), offset by redundancies for Federated and Markel ($8.9). Note that when in any year there is a reserve strengthening or redundancy for a prior year, the amount of the change in favourable (unfavourable) development thereby reflected for that prior year is also reflected in the favourable (unfavourable) development for each year thereafter.

Management is disappointed with the unfavourable development for the Canadian insurance subsidiaries. Future development could be significantly different from the past due to many unknown factors.

U.S. Insurance Subsidiaries

The following table shows for Fairfax's U.S. insurance subsidiaries the provision for claims liability for unpaid losses and LAE as originally and as currently estimated for the years 1997 through 2001. The favourable or unfavourable development from prior years is credited or charged to each year's earnings.

Reconciliation of Provision for Claims – U.S. Insurance Subsidiaries

	2001 *(US$)*	**2000** *(US$)*	**1999** *(US$)*	**1998** *(US$)*	**1997** *(US$)*
Provision for claims and LAE at January 1 for Ranger, for C&F and Falcon beginning in 1999, for TIG beginning in 2000 and for Seneca beginning in 2001	3,138.3	3,138.6	2,693.9	184.0	187.6
Incurred losses on claims and LAE					
Provision for current accident year's claims	1,448.3	1,317.1	624.7	104.5	105.5
Increase in provision for prior accident years' claims	69.4	284.8	29.8	43.8	8.7
Total incurred losses on claims and LAE	1,517.7	1,601.9	654.5	148.3	114.2
Payments for losses on claims and LAE					
Payments on current accident year's claims	(434.7)	(434.6)	(272.5)	(40.5)	(38.0)
Payments on prior accident years' claims	(1,296.4)	(1,215.1)	(755.3)	(70.1)	(79.8)
Total payments for losses on claims and LAE	(1,731.1)	(1,649.7)	(1,027.8)	(110.6)	(117.8)
Provision for claims and LAE at December 31	2,924.9	3,090.8	2,320.6	221.7	184.0
Provision for claims and LAE for Winterthur (Asia) at December 31	16.1	–	–	–	–
Provision for claims and LAE for Seneca Insurance at December 31	–	47.5	–	–	–
Provision for claims and LAE for TIG Specialty Insurance at December 31	–	–	818.0	–	–
Provision for claims and LAE for C&F at December 31	–	–	–	2,466.7	–
Provision for claims and LAE for Falcon at December 31	–	–	–	5.5	–
Provision for claims and LAE for U.S. insurance subsidiaries at December 31 before indemnification	2,941.0	3,138.3	3,138.6	2,693.9	184.0
Reserve indemnification	–	–	–	(34.0)	(34.0)

	2001 (US$)	2000 (US$)	1999 (US$)	1998 (US$)	1997 (US$)
Provision for claims and LAE for U.S. insurance subsidiaries after indemnification	2,941.0	3,138.3	3,138.6	2,659.9	150.0
Exchange rate	*1.5963*	*1.5020*	*1.4513*	*1.5382*	*1.4296*
Converted to Canadian dollars	C$4,694.7	C$4,713.8	C$4,555.0	C$4,091.6	C$ 214.5

The company strives to establish adequate provisions at the original valuation date. It is the company's objective to have favourable development from the past. The reserves will always be subject to upward or downward development in the future.

The following table shows for Fairfax's U.S. insurance subsidiaries the original provision for claims reserves including LAE at each calendar year-end commencing in 1993 (the date of Ranger's acquisition) with the subsequent cumulative payments made from these years and the subsequent re-estimated amounts of these reserves. The following U.S. insurance subsidiaries' reserves are included from the respective years in which such subsidiaries were acquired:

	Year Acquired
Ranger	1993
C&F	1998
Falcon	1998
TIG	1999
Seneca	2000
Winterthur (Asia)	2001

Provision for U.S. Insurance Subsidiaries' Claims Reserve Development

As at December 31	1993 (US$)	1994 (US$)	1995 (US$)	1996 (US$)	1997 (US$)	1998 (US$)	1999 (US$)	2000 (US$)	2001 (US$)
Provision for claims including LAE	173.9	154.9	157.8	187.6	184.0	2,693.9	3,138.6	3,138.3	2,941.0
Cumulative payments as of:									
One year later	78.5	89.1	69.4	79.8	70.1	755.3	1,215.1	1,296.4	
Two years later	141.7	130.0	119.9	125.3	128.0	1,363.2	2,105.3		
Three years later	169.3	158.7	135.2	157.5	168.9	1,822.7			
Four years later	185.8	166.9	155.2	184.1	212.8				
Five years later	188.3	179.9	171.8	204.6					
Six years later	194.4	193.9	174.8						
Seven years later	197.7	193.3							
Eight years later	196.5								
Reserves re-estimated as of:									
One year later	171.4	191.0	183.2	196.3	227.8	2,723.7	3,423.4	3,207.7	
Two years later	199.6	206.9	190.9	229.1	236.3	2,715.8	3,524.2		
Three years later	214.5	216.8	210.8	236.3	251.9	2,765.8			
Four years later	222.2	226.0	212.9	246.7	279.0				
Five years later	227.6	229.8	216.2	261.1					
Six years later	229.4	232.0	220.6						
Seven years later	232.9	235.7							
Eight years later	236.8								
Favourable (unfavourable) development	(62.9)	(80.8)	(62.8)	(73.5)	(95.0)	(71.9)	(385.6)	(69.4)	

Ranger's generally unfavourable development over the years has been a source of significant concern. Ranger's new senior management team took the necessary steps to eliminate and terminate unprofitable lines of business in 1999. Ranger's net adverse development of US$41.0 in 2001 resulted from its discontinued California Artisan Contractors' program where the losses continued to develop with a greater frequency than had been expected (US$34.5, affecting the 1996 to 1998 years), its 1985 and prior discontinued assumed reinsurance program (US$3.0), and its continuing excess umbrella and bail bond programs (US$3.5, affecting the 1998 year).

Crum & Forster recorded gross reserve strengthening for 2000 and prior accident years of US$400. Of the total, US$120 was for the 1999 accident year, US$47 was for the 2000 accident year and the balance was related to the 1998 and prior accident years (including a US$190 cession to fully utilize the vendor-provided reinsurance protection against pre-acquisition adverse claims development and unrecoverable reinsurance).

TIG recorded gross reserve strengthening for 2000 and prior accident years of US$210, of which US$80 was for the 1999 accident year, US$116 was for the 2000 accident year and US$14 was for unallocated loss adjustment expenses.

Note that when in any year there is a reserve strengthening or redundancy for a prior year, the amount of the change in favourable (unfavourable) development thereby reflected for that prior year is also reflected in the favourable (unfavourable) development for each year thereafter.

Management is disappointed with the continuing adverse development in each of the last five years and since the acquisition of Ranger in 1993. Future development could be significantly different from the past due to many unknown factors.

Reinsurance Subsidiaries

The following table shows for Fairfax's reinsurance subsidiaries the provision for claims liability for unpaid losses and LAE as originally and as currently estimated for the years 1997 through 2001. The favourable or unfavourable development from prior years is credited or charged to each year's earnings.

Reconciliation of Provision for Claims – Reinsurance Subsidiaries

	2001 (US$)	2000 (US$)	1999 (US$)	1998 (US$)	1997 (US$)
Provision for claims and LAE at January 1 (in 1997, only for Odyssey Reinsurance (New York) and Wentworth)	2,424.3	2,844.2	2,824.0	2,157.7	858.5
Provision for claims and LAE for CTR, Sphere Drake, RiverStone Stockholm and Dai Tokyo (UK) (transferred to runoff)	(388.2)	(67.4)	(1,264.4)	–	–
Adjusted provision for claims and LAE at January 1	2,036.1	2,776.8	1,559.6	2,157.7	858.5
Incurred losses on claims and LAE					
Provision for current accident year's claims	739.6	523.6	623.7	504.3	150.2
Increase (decrease) in provision for prior accident years' claims	45.8	62.1	(15.9)	26.0	(7.9)
Total incurred losses on claims and LAE	785.4	585.7	607.8	530.3	142.3
Payments for losses on claims and LAE					
Payments on current accident year's claims	(100.2)	(36.9)	(6.4)	(292.3)	(31.1)
Payments on prior accident years' claims	(618.5)	(901.3)	(277.9)	(457.3)	(119.7)
Total payments for losses on claims and LAE	(718.7)	(938.2)	(284.3)	(749.6)	(150.8)
Provision for claims and LAE at December 31	2,102.8	2,424.3	1,883.1	1,938.4	850.0
Provision for claims and LAE for CTR and Sphere Drake at December 31	–	–	–	–	1,307.7
Provision for claims and LAE for RiverStone Stockholm and ORC Re at December 31	–	–	–	885.6	–
Provision for claims and LAE for TIG Re at December 31	–	–	961.1	–	–

	2001 (US$)	2000 (US$)	1999 (US$)	1998 (US$)	1997 (US$)
Provision for claims and LAE for reinsurance subsidiaries at December 31	2,102.8	2,424.3	2,844.2	2,824.0	2,157.7
Exchange rate	*1.5963*	*1.5020*	*1.4513*	*1.5382*	*1.4296*
Converted to Canadian dollars	C$3,356.7	C$3,641.3	C$4,127.8	C$4,343.9	C$3,084.6

The company strives to establish adequate provisions at the original valuation date. It is the company's objective to have favourable development from the past. The reserves will always be subject to upward or downward development in the future.

The following table shows for Fairfax's reinsurance subsidiaries the original provision for claims reserves including LAE at each calendar year-end commencing in 1996 (the date of Odyssey Reinsurance (New York)'s acquisition) with the subsequent cumulative payments made from these years and the subsequent re-estimated amount of these reserves. The following reinsurance subsidiaries' reserves are included from the respective years in which such subsidiaries were acquired:

Odyssey Reinsurance (New York)	1996
CTR (transferred to runoff January 1, 2001)	1997
Sphere Drake (transferred to runoff July 1, 1999)	1997
TIG Re (now Odyssey America Re)	1999

Provision for Reinsurance Subsidiaries' Claims Reserve Development

As at December 31	**1996** *(US$)*	**1997** *(US$)*	**1998** *(US$)*	**1999** *(US$)*	**2000** *(US$)*	**2001** *(US$)*
Provision for claims including LAE	858.5	2,157.7	2,824.0	2,844.2	2,424.3	2,102.8
Provision for claims including LAE for Sphere Drake, RiverStone Stockholm and Dai Tokyo (UK) (transferred to runoff)	–	(886.5)	(1,264.4)	(67.4)	–	–
Provision for claims including LAE for CTR (transferred to runoff)	–	(420.4)	(451.7)	(546.5)	(388.2)	–
Adjusted provision for claims including LAE	858.5	850.8	1,107.9	2,230.3	2,036.1	2,102.8
Cumulative payments as of:						
One year later	119.7	124.9	50.3	630.8	618.5	
Two years later	229.1	231.5	180.1	1,111.8		
Three years later	314.0	332.6	288.5			
Four years later	387.6	410.0				
Five years later	447.8					
Reserves re-estimated as of:						
One year later	850.6	833.6	1,113.9	2,239.5	2,081.9	
Two years later	834.3	840.5	1,132.5	2,262.7		
Three years later	857.2	847.8	1,117.8			
Four years later	868.9	820.1				
Five years later	852.1					
Favourable (unfavourable) development	6.4	30.7	(9.9)	(32.4)	(45.8)	

The unfavourable development of US$45.8 in 2001 was primarily due to adverse development on the 1997 to 2000 excess casualty business (US$16.2), strengthening of APH reserves for years prior to 1995 (US$15.0) and adverse development on the Newline Lloyd's syndicate discontinued North American treaty and binder business affecting the 1997 to 2000 years (US$4.6). Note that when in any year there is a reserve strengthening or redundancy for a prior year, the amount of the change in favourable (unfavourable) development thereby reflected for that prior year is also reflected in the favourable (unfavourable) development for each year thereafter.

Future development could be significantly different from the past due to many unknown factors.

Runoff Subsidiaries

The following table shows for Fairfax's runoff subsidiaries the provision for claims liability for unpaid losses and LAE as originally and as currently estimated since 1998 (the date of RiverStone Stockholm's acquisition). The favourable or unfavourable development from prior years is credited or charged to each year's earnings.

Reconciliation of Provision for Claims –
Runoff Subsidiaries

	2001 (US$)	2000 (US$)	1999 (US$)
Provision for claims and LAE at January 1 for RiverStone Stockholm and Sphere Drake, and for TRG beginning in 2000	1,536.4	1,795.8	1,264.5
Provision for claims and LAE for CTR and Dai Tokyo (UK) (transferred to runoff)	388.2	67.4	–
	1,924.6	1,863.2	1,264.5
Incurred losses on claims and LAE			
Foreign exchange effect on claims	24.8	5.0	(19.1)
Provision for current accident year's claims	46.5	155.7	187.8
Increase in provision for prior accident years' claims	184.8	123.1	40.7
Total incurred losses on claims and LAE	256.1	283.8	209.4
Payments for losses on claims and LAE			
Payments on current accident year's claims	0.1	(46.7)	(99.4)
Payments on prior accident years' claims	(646.9)	(563.9)	(180.4)
Total payments for losses on claims and LAE	(646.8)	(610.6)	(279.8)
Provision for claims and LAE at December 31	1,533.9	1,536.4	1,194.1
Provision for claims and LAE for TRG at December 31	–	–	601.7
Provision for claims and LAE for runoff subsidiaries at December 31	1,533.9	1,536.4	1,795.8
Exchange rate	*1.5963*	*1.5020*	*1.4513*
Converted to Canadian dollars	C$2,448.6	C$2,307.7	C$2,606.3

The unfavourable development of US$184.8 in 2001 related to additional development on Sphere Drake's 1996 and subsequent reserves of US$191.0, adverse development on CTR's 2000 and prior claims of US$15.5, and adverse development on TRG's 1992 and prior claims of US$10.1, partially offset by favourable development of US$31.8 on RiverStone Stockholm's claims. Approximately 70% of the runoff claims reserves are expected to be paid out over the next five years (80% over the next ten years).

The company strives to establish adequate provisions at the original valuation date. It is the company's objective to have favourable development from the past. The reserves will always be subject to upward or downward development in the future.

Asbestos, Pollution and Other Hazards

A number of Fairfax's subsidiaries wrote insurance and reinsurance policies prior to their acquisition by Fairfax which involve asbestos-related, environmental pollution and other hazards (APH) coverage, primarily in the United States. Following is an analysis of Fairfax's gross and net reserves from APH exposures at year-end 2001 and 2000 and the movement in gross and net reserves for those years. The second table excludes TRG, since Fairfax's exposure to loss at TRG is limited to its US$97 investment, as discussed under Runoff on page 57.

	2001		2000	
	Gross *(US$)*	**Net** *(US$)*	**Gross** *(US$)*	**Net** *(US$)*
Provision for APH claims and LAE at January 1	2,411.5	1,049.3	2,634.7	962.4
APH losses and LAE incurred during the year	320.8	142.7	420.7	203.1
APH losses and LAE paid during the year	(480.9)	(202.3)	(675.5)	(139.8)
Provision for APH claims and LAE at December 31	2,251.4	989.7	2,379.9	1,025.7
Dai Tokyo (UK) provision for APH claims and LAE at December 31	–	–	31.6	23.6
Total provision for APH claims and LAE at December 31	2,251.4	989.7	2,411.5	1,049.3
Comprising:				
Outstanding	791.9	249.3	958.6	267.8
IBNR	1,459.5	740.4	1,452.9	781.5

Excluding TRG

	2001		2000	
	Gross *(US$)*	**Net** *(US$)*	**Gross** *(US$)*	**Net** *(US$)*
Provision for APH claims and LAE at January 1	1,154.5	716.4	1,042.4	639.9
APH losses and LAE incurred during the year	167.7	127.1	231.5	146.4
APH losses and LAE paid during the year	(337.2)	(187.6)	(151.0)	(93.5)
Provision for APH claims and LAE at December 31	985.0	655.9	1,122.9	692.8
Dai Tokyo (UK) provision for APH claims and LAE at December 31	–	–	31.6	23.6
Total provision for APH claims and LAE at December 31	985.0	655.9	1,154.5	716.4
Comprising:				
Outstanding	325.2	205.3	374.9	221.8
IBNR	659.8	450.6	779.6	494.6

The 2001 gross amount of US$2,251.4 is included in the $22,085.8 shown as Provision for claims at December 31, 2001 on Fairfax's consolidated balance sheet on page 25.

Since Fairfax's acquisition of TRG in 1999, RiverStone has largely managed all of the group's APH claims. RiverStone is focused on commuting or buying back major APH exposures and APH-exposed policies. In 2001, Fairfax commuted its liabilities assumed and reinsurance

recoverable (excluding certain facultative contracts) balances with Equitas, and settled another commutation involving substantial APH exposure. In 2000, there was a buyback and cancellation of a major APH-exposed policy. These commutations were beneficial to the company. However, because a commutation (which includes for this purpose a buyback and cancellation) constitutes a prepayment of the commuted claims, the effect of these commutations on the foregoing tables is to create an unrealistic amount of paid claims in the year of commutation. These commutations in effect removed any liability for the APH claims settled by the commutations; therefore, a more informative presentation of the analysis intended to be presented in the foregoing tables would be to eliminate the commuted exposures both from the provision for APH claims and from the APH losses and LAE incurred and paid, as shown in the following table, which again excludes TRG. (Note that it is reasonable to expect that the portion of the incurred and paid net losses shown in the following table which relate to Crum & Forster will ultimately be recovered under Crum & Forster's stop loss protections.)

	2001		2000	
	Gross *(US$)*	**Net** *(US$)*	**Gross** *(US$)*	**Net** *(US$)*
Provision for APH claims and LAE at January 1	979.5	635.2	831.7	561.4
APH losses and LAE incurred during the year	168.1	127.6	205.8	137.7
APH losses and LAE paid during the year	(162.6)	(106.9)	(89.6)	(87.5)
Provision for APH claims and LAE at December 31	985.0	655.9	947.9	611.6
Dai Tokyo (UK) provision for APH claims and LAE at December 31	–	–	31.6	23.6
Total provision for APH claims and LAE at December 31	985.0	655.9	979.5	635.2
Comprising:				
Outstanding	331.1	210.2	318.1	196.7
IBNR	653.9	445.7	661.4	438.5
Survival ratio – 3 year (before reinsurance protection)		6.7		7.2
Survival ratio – 3 year (after reinsurance protection)		9.1		11.1

The 3-year survival ratio represents the outstanding APH claims and LAE (including IBNR) at December 31 divided by the average paid APH claims for the last three years. The survival ratio after reinsurance protection includes one-half of the remaining reinsurance protection at December 31, 2001 for Crum & Forster and one-half of Fairfax's remaining Swiss Re cover. Based on the preceding table, Fairfax's 3-year survival ratio before and after reinsurance protection was 6.7 and 9.1 years respectively, which compares favourably with A.M. Best Co's normalized (to exclude unusually large Fibreboard asbestos payouts) 3-year average survival ratio of 6.7 years for the U.S. property and casualty insurance industry, as set out in their special report dated November 5, 2001 on U.S. property and casualty insurers' and reinsurers' December 31, 2000 asbestos and environmental claims reserve information. (That report also recognized that companies which aggressively pursue buybacks to seal off future claims (as

Fairfax does) will record higher payouts, lower reserves, and therefore, correspondingly lower survival ratios.)

Many insurance coverage issues and circumstantial uncertainties make the estimation of these reserves very difficult. Inconsistencies among the States with regard to coverage, occurrence definitions and Superfund reform can all affect the outcome of APH claims. Also, beginning in 2000, there was renewed asbestos liability activity primarily relating to the emergence of so-called non-products liability claims. Generally, as asbestos defendants, especially manufacturers of products containing asbestos, exhaust available product hazard coverage, they are increasingly seeking to expand available insurance coverage by alleging that the asbestos claims to which they are subject are not product hazard claims, but are rather so-called non-products claims for which the liability limits of their insurance have not been exhausted.

These APH reserves are continuously monitored by management and are reviewed extensively by independent consulting actuaries. The reinsurance protection discussed under Additional Reinsurance Protection on page 79 would apply to adverse development of APH reserves.

Reinsurance Recoverables

Fairfax's subsidiaries purchase certain reinsurance so as to reduce their liability on the insurance and reinsurance risks which they write. Fairfax strives to minimize the credit risk of purchasing reinsurance through adherence to its internal reinsurance guidelines. To be an ongoing reinsurer of Fairfax, a company must have high A.M. Best and/or Standard & Poor's ratings and maintain capital and surplus exceeding US$500. Most of the reinsurance balances for reinsurers rated B++ and lower or which are not rated were inherited by Fairfax on acquisition of a subsidiary. The risk of uncollectible reinsurance has been mitigated by the additional reinsurance protection outlined under Additional Reinsurance Protection on page 79. Certain of the tables and commentary in this section treat TRG-related balances as excluded from Fairfax, since Fairfax's exposure to loss at TRG is limited to its US$97 investment, as discussed under Runoff on page 57.

The following table shows Fairfax's top 50 reinsurance groups (based on gross reinsurance recoverable) at December 31, 2001, excluding TRG-related balances. These 50 reinsurance groups represent 91.1% of Fairfax's $10,770.0 in total reinsurance recoverable, excluding TRG-related balances (which total is net of bad debt reserves aggregating $293.2).

Group	**Principal Reinsurers**	**A.M. Best Rating (or S&P equivalent)[1]**	**Gross Reinsurance Recoverable**	**Net Reinsurance Recoverable[2]**
Swiss Re	European Reinsurance Co. of Zurich	A++	2,288.3	1,526.4
Munich Re	American Reinsurance	A++	1,068.1	423.1
Great West Life	London Life & Casualty Reinsurance	A	821.6	57.1
General Electric	GE Frankona Ruck, A.G.	A++	633.5	626.3
Zurich Re	Zurich Reinsurance (N.A.) Inc.	A	579.7	457.5
Lloyd's	Lloyd's of London Underwriters	A–	419.9	377.6
Aegon	ARC Re & Pyramid Insurance Companies	NR	417.9	3.8
Berkshire Hathaway	General Reinsurance Corp.	A++	398.2	373.2

Group	Principal Reinsurers	A.M. Best Rating (or S&P equivalent)[1]	Gross Reinsurance Recoverable	Net Reinsurance Recoverable[2]
St. Paul	Mountain Ridge Ins. Co. of N.A.[3]	NR	359.9	139.8
Gerling Global	Gerling Global International Re	A	309.9	134.5
Royal & Sun Alliance	Security Ins. Co. of Hartford	A+	199.3	199.3
AXA	AXA Corporate Solutions	A+	180.7	95.0
CNA	Continental Casualty	A	174.8	150.2
Chubb	Federal Ins. Co.	A++	173.0	81.7
AIG	Transatlantic Re	A++	171.6	159.8
HDI	Hannover Ruck	A+	134.8	102.9
Phoenix	Enterprise Group Ins. Co.	NR	117.1	1.2
Ace	Insurance Co. of North America	A	109.9	99.3
XL	XL Reinsurance America Inc.	A+	103.1	97.8
Hartford[4]	New England Re	B+	80.1	74.9
Everest	Everest Reinsurance Co.	A+	74.4	65.8
Nationwide	Nationwide Mutual Insurance Company	A+	72.7	72.2
White Mountains	Folksamerica Reinsurance Co.	A–	68.9	63.4
Aioi	Aioi Insurance Co. Ltd.	A+[5]	57.6	55.0
Manulife[6]	Manufacturers P&C Barbados	NR	53.3	27.7
SCOR	SCOR	A+	52.1	45.8
GROUPAMA	GAN Life	BBB[5]	51.9	12.5
Trenwick	Trenwick America Reinsurance Co.	A–	48.6	39.5
AMP	GIO Australia Ltd	BBB[5]	43.7	40.6
PMA	PMA Capital Insurance Co.	A	42.9	34.0
PartnerRe	Partner Reinsurance Co. of US	A+	42.5	29.2
HCC	Houston Casualty Co.	A+	39.5	32.4
American Financial	Great American Assurance Co.	A	37.6	31.7
Liberty Mutual	Employers Insurance of Wausau	A+	34.7	32.0
Citigroup	Travelers Indemnity Co.	A++	32.4	32.1
Allstate	Allstate	A+	28.2	26.4
Toa Re	Toa Reins. Co. Ltd.	A+	28.1	25.1
BRIT	BRIT Insurance	A–	27.0	26.8
Markel	Terra Nova Insurance Co. Ltd.	A–	23.7	20.3
Unum/Provident	Unum Life Ins. Of America	A	23.4	23.4
BCHS	Blue Cross	NR	22.5	—
Allianz	Cornhill Ins. Co.	A++	21.2	19.0
Planet	Planet Insurance	NR	20.7	2.9
Taisei	Taisei F&M Insurance Company	NR	20.2	20.1
Charter Re	Charter Re	NR	20.0	20.0
PXRE	PXRE Reinsurance Co.	A	19.8	19.7
Nissan	Nissan Fire & Marine Insurance Co.	A	19.3	19.0
Sentry Group	Sentry Ins., a Mutual Co.	A+	17.5	17.5
W.R. Berkley	Berkley Insurance Co.	A	15.9	14.0
CGNU	London & Edinbrugh Insurance Co. Ltd.	B+	15.0	14.3
Other reinsurers			1,246.5	1,080.1
Total reinsurance recoverable			11,063.2	7,143.9
Provision for uncollectible reinsurance			293.2	293.2
Net reinsurance recoverable			10,770.0	6,850.7

(1) Of principal reinsurer

(2) *Net of outstanding balances for which security is held, but before specific provisions for uncollectible reinsurance*

(3) *Fully secured by letters of credit and/or trust funds (gross reinsurance recoverable from Mountain Ridge is $200.3 million)*

(4) *Rated A+ by A.M. Best*

(5) *S&P rating*

(6) *Rated A++ by A.M. Best*

The following table shows the classification of the $11,063.2 total reinsurance recoverable, excluding TRG-related balances, shown above by credit rating of the responsible reinsurers. (This and the following table reflect some reclassifications, from those disclosed last year, of outstanding balances for which security is held. Pools and associations, now shown separately, are generally government or similar insurance funds carrying very little credit risk.)

	A.M. Best Rating (or S&P equivalent)	Gross Reinsurance Recoverable	Outstanding Balances for which Security is Held	Provision for Uncollectible Reinsurance	Net Unsecured Reinsurance Recoverable
	A++	3,879.4	837.4	5.8	3,036.2
	A+	1,369.2	199.8	0.8	1,168.6
	A	2,795.6	1,730.0	8.8	1,056.8
	A–	909.4	197.7	0.7	711.0
	B++	127.2	16.6	1.6	109.0
	B+	204.8	19.3	4.1	181.4
	B	25.3	10.6	5.7	9.0
	Lower than B	97.3	1.4	53.2	42.7
	Not rated	1,485.4	904.0	165.0	416.4
	Pools & associations	169.6	2.5	—	167.1
		11,063.2	3,919.3	245.7	6,898.2
Provision for uncollectible reinsurance					
– specific		245.7			
– general		47.5			
Net reinsurance recoverable		10,770.0			

To support gross reinsurance recoverable balances, Fairfax has the benefit of letters of credit, trust funds or offsetting balances payable totalling $3,919.3, as follows:

for reinsurers rated A– or better, Fairfax has security of $2,964.9 against outstanding reinsurance recoverable of $8,953.6;

for reinsurers rated B++ or lower, Fairfax has security of $47.9 against outstanding reinsurance recoverable of $454.6;

for unrated reinsurers, Fairfax has security of $904.0 against outstanding reinsurance recoverable of $1,485.4; and

for pools & associations, Fairfax has security of $2.5 against outstanding reinsurance recoverable of $169.6.

Lloyd's is also required to maintain funds in Canada and the United States which are monitored by the applicable regulatory authorities.

As shown above, excluding pools & associations, Fairfax has gross outstanding reinsurance balances for reinsurers which are rated B++ or lower or which are unrated of $1,940.0 for which it holds security of $951.9 and has an aggregate provision for uncollectible reinsurance of $277.1 (28% of the net exposure prior to such provision), leaving a net exposure of $711.0. Fairfax believes that its provision for uncollectible reinsurance provides for all likely losses arising from uncollectible reinsurance at December 31, 2001.

On June 28, 2001, Fairfax completed a settlement of all claims liabilities and all reinsurance recoverable from Equitas (excluding certain facultative reinsurance). The aggregate amount of claims liabilities and reinsurance recoverable settled was approximately $520 and $480 respectively.

The following table shows the classification of the $13,838.2 total gross reinsurance recoverable, including TRG-related balances, by credit rating of the responsible reinsurers. This table is identical to the preceding table, except that it includes TRG-related balances. As discussed under Runoff on page 57, Fairfax's exposure to loss at TRG is limited to its US$97 investment.

	A.M. Best Rating (or S&P equivalent)	Gross Reinsurance Recoverable	Outstanding Balances for which Security is Held	Provision for Uncollectible Reinsurance	Net Unsecured Reinsurance Recoverable
	A++	4,095.5	894.5	19.3	3,181.7
	A+	1,644.7	226.6	4.2	1,413.9
	A	3,132.7	1,731.3	11.9	1,389.5
	A–	949.2	199.3	2.9	747.0
	B++	145.4	20.5	1.6	123.3
	B+	281.0	20.2	7.1	253.7
	B	26.8	10.6	5.7	10.5
	Lower than B	139.5	1.4	82.2	55.9
	Not rated	3,211.5	1,676.2	682.0	853.3
	Pools & associations	211.9	2.7	—	209.2
		13,838.2	4,783.3	816.9	8,238.0
Provision for uncollectible reinsurance					
– specific		816.9			
– general		219.2			
Net reinsurance recoverable		12,802.1			

The reinsurance protection discussed under Additional Reinsurance Protection on page 79 would apply to adverse development of unrecoverable reinsurance.

Additional Reinsurance Protection

At December 31, 2000, the company had unutilized indemnifications relating to its acquisition of CTR, Sphere Drake and Crum & Forster of $23, $47 and $259 respectively. In 2001, the company settled the CTR indemnity with the vendor at fair value. The Sphere Drake and Crum & Forster vendor indemnities were fully utilized during 2001.

Shown below are the continuing indemnifications originally received by Fairfax on the acquisition of its various insurance and reinsurance subsidiaries and additional reinsurance protection purchased by Fairfax in 1999 and Crum & Forster in 2001. These protect Fairfax from adverse development in the respective companies' claims reserves and unrecoverable reinsurance as at the end of the respective original years shown. The protected net reserves represent the respective companies' carried reserves, net of reinsurance recoverable, at December 31, 2001, which are subject to the related protection.

During 1999, the indemnity in respect of Odyssey Reinsurance (New York) was assumed by a Fairfax reinsurance subsidiary in consideration of a cash payment made to that reinsurer, which Fairfax believes represented fair value to assume that indemnity.

Year	Company	Amount (US$)	Amount (C$)	Unused Protections at December 31, 2001 (C$)	Protected Net Reserves at December 31, 2001 (C$)
1992	International Insurance (TRG)	US$ 578[2]	923[2]	186	136
1995[1]	Odyssey Reinsurance (New York)	US$ 175	279	112	1,483
1998	All Fairfax subsidiaries owned at the end of 1998 and TIG (Swiss Re cover)[4]	US$1,000[3]	1,596	435	5,389
2001	Crum & Forster	US$ 400[3]	639	303	1,633
			2,514	850	

(1) This indemnity is provided by a Fairfax reinsurance subsidiary, as described above.

(2) After coinsurance

(3) Additional premium is payable as additional losses are ceded to this cover.

(4) Effective June 14, 2001, with the Odyssey IPO, the net reserves of Odyssey America Re and Odyssey Reinsurance (New York) are no longer covered.

Insurance Environment

The property and casualty insurance market changed significantly in 2001 following the September 11th terrorist attacks. Many reinsurers and insurers suffered substantial losses on the World Trade Center catastrophe; in addition, their capital and surplus has been negatively impacted by falling equity values. Since September 11, 2001, insurance and reinsurance prices have been increasing significantly as capacity and terms and conditions tighten dramatically. Combined ratios in Canada, for U.S. commercial lines and for U.S. reinsurance in 2001 are expected to be approximately 108%, 118% and 145% respectively. The World Trade Center

losses and continuing adverse development from very inadequate pricing in 2000 and prior years negatively impacted on 2001 combined ratios. Significant restructuring and consolidation continues to take place in the industry, and the industry continues to be highly competitive.

Acquisitions

Effective December 20, 2001, the company purchased Winterthur Swiss Insurance (Asia) Limited for US$14.5 (Cdn$23.1) cash. At the date of acquisition, the company had US$122.7 (Cdn$195.8) in total assets and US$108.2 (Cdn$172.7) in total liabilities. The balance sheet of Winterthur (Asia) upon acquisition was as follows:

	(US$)
Investments, including cash	71.3
Accounts receivable, including reinsurance	47.0
Other assets	4.4
Total assets	122.7
Provision for claims	82.9
Other liabilities	25.3
Shareholders' equity	14.5

Interest and Dividend Income

The majority of interest and dividend income is earned by the insurance, reinsurance and runoff companies. Upon the acquisitions noted below, the respective amounts shown below were added to the company's portfolio investments.

Acquisition Date	Company Acquired	Portfolio Investments
March 21, 1990	Federated	101
November 14, 1990	Commonwealth	130
December 31, 1993	Ranger	400
November 30, 1994	Lombard (including CRC (Bermuda))	684
May 31, 1996	Odyssey Reinsurance (New York)	1,490
February 27, 1997	CTR	764
December 3, 1997	Sphere Drake	1,068
August 13, 1998	Crum & Forster	4,955
September 4, 1998	RiverStone Stockholm	831
April 13, 1999	TIG	5,597
August 11, 1999	TRG	1,670

	Average Investments at Carrying Value	Interest and Dividend Income					
		Pre-Tax			After Tax		
		Amount	Yield (%)	Per Share ($)	Amount	Yield (%)	Per Share ($)
1985	29.1	2.4	8.45	0.87	1.3	4.37	0.45
1986	64.2	4.7	7.29	0.96	2.5	3.93	0.52
1987	109.8	8.0	7.32	1.10	5.5	5.01	0.77
1988	130.8	8.9	6.82	1.22	6.6	5.06	0.90
1989	135.7	11.6	8.57	1.51	8.5	6.29	1.11
1990	237.9	20.7	8.70	2.75	14.0	5.89	1.86
1991	338.5	26.1	7.70	4.44	17.7	5.24	3.02
1992	366.5	24.0	6.55	4.17	17.8	4.84	3.09
1993	418.2	23.3	5.56	3.78	18.0	4.30	2.92
1994	852.0	58.2	6.83	7.12	39.6	4.65	4.85
1995	1,608.1	89.4	5.56	10.00	73.7	4.58	8.25
1996	2,548.1	151.4	5.94	15.42	111.5	4.37	11.35
1997	4,584.6	254.6	5.55	23.64	174.4	3.80	16.19
1998	8,877.5	443.8	5.00	37.37	337.5	3.80	28.42
1999	14,684.0	753.0	5.13	56.48	492.0	3.35	36.91
2000	16,306.2	818.1	5.02	62.10	578.4	3.55	43.91
2001	15,542.0	680.8	4.38	51.41	462.9	2.98	34.96

Interest and dividend income decreased in 2001 due to the decrease in the average investments resulting from negative cash flows at the U.S. insurance companies and OdysseyRe as those companies re-underwrote their business, and from the ongoing reduction of the runoff claims portfolios. As shown, the pre-tax and after tax income yields decreased in 2001 due to lower interest rates and the impact of higher interest expense on funds withheld payable to reinsurers of $43.9, partially offset by a weaker Canadian dollar. Since 1985, pre-tax interest and dividend income per share has compounded at 29.0% per year.

Investments for the past seventeen years are shown in the following table, the first five columns of which show them at their average carrying values for each year, and the final two columns of which show them at their year-end carrying values.

	Cash and Short Term Investments	Bonds	Preferred Stocks	Common Stocks	Total Investments Average	Total Investments Year-End	Total Investments Per Share ($)
1985	10.5	15.4	0.8	2.4	29.1	32.8	6.55
1986	16.6	24.5	8.0	15.1	64.2	95.6	13.65
1987	28.0	26.2	16.5	39.1	109.8	124.0	16.90
1988	29.8	23.6	25.2	52.2	130.8	137.6	18.79
1989	20.6	28.5	32.2	54.4	135.7	133.9	18.30
1990	33.6	99.2	45.7	59.4	237.9	335.7	61.30
1991	60.1	140.2	75.7	62.5	338.5	341.2	62.54
1992	78.0	108.8	99.8	79.9	366.5	396.2	65.44
1993	103.0	90.7	118.6	105.9	418.2	848.8	106.70
1994	226.2	303.9	132.1	189.8	852.0	1,551.3	173.25
1995	298.0	796.3	157.0	356.8	1,608.1	1,668.7	188.14
1996	470.7	1,462.1	168.4	446.9	2,548.1	3,454.5	330.07
1997	822.6	2,989.1	226.9	546.0	4,584.6	5,795.7	520.62
1998	1,116.3	6,856.7	213.3	691.2	8,877.5	12,108.4	998.03
1999	1,858.6	11,583.3	144.5	1,097.6	14,684.0	17,478.7	1,298.57
2000	2,530.2	12,532.5	102.1	1,141.4	16,306.2	15,290.7	1,167.15
2001	2,794.3	11,751.8	98.5	897.4	15,542.0	15,947.9	1,111.28

Total investments and total investments per share decreased at year-end 2001 due to the payment of claims by the runoff operations and by Crum & Forster and Ranger which significantly reduced premium volumes from 1997 to 2000 as they re-underwrote their business. Since 1985, investments per share have compounded at 37.8% per year.

The breakdown of the bond portfolio, by the higher of the S&P and Moody's credit ratings, as at December 31, 2001 was as follows:

Credit Rating	Carrying Value	Market Value	Unrealized gain/(loss)
AAA	6,271.0	6,090.9	(180.1)
AA	1,326.9	1,322.6	(4.3)
A	2,229.5	2,223.6	(5.9)
BBB	1,725.9	1,616.7	(109.2)
BB	156.1	135.8	(20.3)
B	22.3	22.2	(0.1)
Lower than B and unrated	13.6	12.4	(1.2)
Total	11,745.3	11,424.2	(321.1)

98.4% of the fixed income portfolio is rated investment grade, with 83.7% being rated A or better.

Return on Investment Portfolio

The following table shows the performance of the investment portfolio for the past seventeen years. The total return includes all interest and dividend income, gains (losses) on the disposal of securities and the change in the unrealized gains (losses) during the year.

	Average Investments at Carrying Value	Interest and Dividends Earned	Realized Gains (Losses) after Provisions	Change in Unrealized Gains (Losses)	Total Return on Average Investments	(%)
1985	29.1	2.4	0.5	0.9	3.8	13
1986	64.2	4.7	1.0	(0.4)	5.3	8
1987	109.8	8.0	9.2	(8.0)	9.2	8
1988	130.8	8.9	7.8	12.1	28.9	22
1989	135.7	11.6	15.5	(6.3)	20.8	15
1990	237.9	20.7	2.3	(33.0)	(10.0)	(4)
1991	338.5	26.1	(4.5)	27.8	49.4	15
1992	366.5	24.0	3.4	(11.2)	16.2	4
1993	418.2	23.3	27.8	28.8	79.9	19
1994	852.0	58.2	20.0	(42.4)	35.8	4
1995	1,608.1	89.4	71.9	45.4	206.7	13
1996	2,548.1	151.4	131.3	112.6	395.3	16
1997	4,584.6	254.6	206.8	(4.5)	456.9	10
1998	8,877.5	443.8	440.8	(117.2)	767.4	9
1999	14,684.0	753.0	121.6	(1,232.1)	(357.5)	(2)
2000	16,306.2	818.1	382.8	737.4	1,938.3	12
2001	15,542.0	680.8	162.3	212.0	1,055.1	7

Investment gains (losses) have been an important component of Fairfax's net earnings since 1985. The amount has fluctuated significantly from period to period, but the amount of investment gains (losses) for any period has no predictive value and variations in amount from period to period have no practical analytic value. At December 31, 2001, the aggregate provision for losses on investments was $37.4 (2000 – $22.7). At December 31, 2001 the Fairfax investment portfolio had an unrealized loss of $277.2 compared to an unrealized loss at December 31, 2000 of $489.2.

The company has a long term value-oriented investment philosophy. It continues to expect fluctuations in the stock market.

Capital Resources

At December 31, 2001, total capital, comprising shareholders' equity and non-controlling (minority) interests, was $4,300.9, compared to $4,025.5 at December 31, 2000.

The following table shows the level of capital as at December 31 for the past five years:

	2001	2000	1999	1998	1997
Non-controlling interests	1,043.3	645.2	601.6	87.9	20.5
Common shareholders' equity	3,057.6	3,180.3	3,116.0	2,238.9	1,395.7
Preferred stock	200.0	200.0	200.0	–	–
	4,300.9	4,025.5	3,917.6	2,326.8	1,416.2

Fairfax's consolidated balance sheet as at December 31, 2001 continues to reflect significant financial strength. Fairfax's common shareholders' equity decreased from $3,180.3 at December 31, 2000 to $3,057.6 at December 31, 2001 as a result of the 2001 loss of $346.0 and preferred dividends and related dividend tax (for 2001 and 2000) of $25.2, offset by a common share issue of $248.5.

The company has issued and repurchased common shares over the last five years as follows:

Date	Number of subordinate voting shares	Average issue/repurchase price per share ($)	Net proceeds/ repurchase cost
1997 – issue of shares	671,472	393.30	253.7
– repurchase of shares	(5,100)	308.82	(1.6)
1998 – issue of shares	1,000,000	475.00	455.6
1999 – issue of shares	2,000,000	500.00	959.7
– repurchase of shares	(706,103)	292.88	(206.8)
2000 – repurchase of shares	(325,309)	183.47	(59.7)
2001 – issue of shares	1,250,000	200.00	248.5

Fairfax's indirect ownership of its own shares through The Sixty Two Investment Company Limited results in an effective reduction of shares outstanding by 799,230, and this reduction has been reflected in the earnings per share and book value per share figures.

A common measure of capital adequacy in the property and casualty industry is the premiums to surplus (or common shareholders' equity) ratio. This is shown for the insurance and reinsurance subsidiaries of Fairfax for the past five years in the following table:

	Net Premiums Written to Surplus (Common Shareholders' Equity)				
	2001	**2000**	**1999**	**1998**	**1997**
Insurance					
Commonwealth	1.1	0.5	0.3	0.5	0.6
Crum & Forster	0.5	0.5	0.6	0.7	–
Falcon	0.4	0.3	0.3	0.1	–
Federated	1.8	1.7	1.6	1.6	1.2
Lombard	2.5	2.0	1.7	1.7	1.4
Markel	1.7	1.4	1.1	1.3	0.9
Ranger	0.9	0.4	0.8	1.2	1.1
TIG Specialty Insurance	0.7	0.8	1.1	–	–
Reinsurance					
OdysseyRe	1.0	0.7	0.6	0.5	0.5
Canadian insurance industry	1.4	1.3	1.2	1.2	1.2
U.S. insurance industry	1.2	0.9	0.8	0.8	0.9

In Canada, property and casualty companies are regulated by the Office of the Superintendent of Financial Institutions on the basis of their Section 516 surplus. At December 31, 2001, Fairfax's Canadian property and casualty insurance subsidiaries had a combined Section 516 surplus of approximately $206 (2000 – $241) in excess of minimum requirements.

In the U.S., the National Association of Insurance Commissioners (NAIC) has developed a model law and risk-based capital (RBC) formula designed to help regulators identify property and casualty insurers that may be inadequately capitalized. Under the NAIC's requirements, an insurer must maintain total capital and surplus above a calculated threshold or face varying levels of regulatory action. The threshold is based on a formula that attempts to quantify the risk of a company's insurance, investment and other business activities. Fairfax does not anticipate any adverse effects of such requirements. At the end of 2001, the U.S. insurance and reinsurance subsidiaries had capital and surplus in excess of the regulatory minimum requirement of two times the authorized control level – except for TIG, each subsidiary had capital and surplus in excess of three times the authorized control level. The company's objective is for TIG to have capital and surplus in excess of three times the authorized control level. Subsequent to December 31, 2001 Fairfax contributed additional capital of $69 (US$43) to TIG as part of its commitment to strengthen TIG's capital ratio. TIG does not intend to pay dividends until it has capital and surplus in excess of three times the authorized control level.

Fairfax and its insurance and reinsurance subsidiaries are rated as follows by the respective rating agencies:

	A.M. Best	Standard & Poor's	Fitch	DBRS	Moody's
Fairfax	bbb–	BB+	BB+	BBB–	Ba2
Commonwealth	A–	BBB	BBB+	–	–
Crum & Forster	A–	BBB	BBB+	–	Baa2
Falcon	–	BBB	–	–	–
Federated	A–	BBB	BBB+	–	–
Lombard	A–	BBB	BBB+	–	–
Markel	A–	BBB	BBB+	–	–
Ranger	B++	–	BBB+	–	–
TIG Specialty Insurance	B++	BBB	BBB+	–	–
CRC (Bermuda)	A–	–	–	–	–
OdysseyRe	A	A–	A–	–	Baa1

Liquidity

The purpose of liquidity management is to ensure that there is sufficient cash to meet all financial commitments and obligations as they fall due.

Fairfax's combined holding company earnings statement is set out on page 101, and its composition is explained on page 92. As shown, the holding companies had revenue of $223.6 in 2001, consisting of dividends from their insurance and reinsurance subsidiaries ($54.9), interest income ($8.8), management fees ($24.5) and realized gains ($135.4). After interest expense ($166.0) and operating and other expenses ($58.1), the holding companies had a nominal pre-tax loss. The operating expenses include, besides administration expenses, the cost of Fairfax's corporate catastrophe cover from Swiss Re and certain systems and other costs of insurance subsidiaries reimbursed by the holding companies. This income statement shows that in 2001, Fairfax essentially met all its obligations from internal sources.

For 2002, Fairfax's access to dividends from its subsidiaries has declined to $232 from $343 in 2001. Based on its access to these dividends, its receipt of management fees and its cash holding, Fairfax should again meet all its debt service and overhead obligations from internal sources.

At the end of 2001, Fairfax had a large cash and marketable securities holding of $833.4 available to meet upcoming obligations and unexpected requirements absent any other source of funds. If not used for these purposes, the cash in the holding company would permit Fairfax to meet its net interest, preferred dividend and other overhead expenses for three to four years, without access to any dividends from its insurance and reinsurance subsidiaries. As noted on pages 59 and 85 respectively, subsequent to December 31, 2001 Fairfax paid Swiss Re a premium of $97 (and will pay a further premium of $46 in the second quarter), and contributed additional capital of $69 to TIG, out of its cash holding. In connection with arrangements for the use of cash derived from the OdysseyRe IPO, Fairfax will repay US$100 to TIG in June 2002, and would receive US$50 in respect of the remaining amount of OdysseyRe's term note issued on its IPO if that note is refinanced externally. Payments may also be required

during 2002 on the foreign exchange contracts referred to in notes 1 (under Translation of foreign currencies) and 16 to the financial statements.

Also, as of February 28, 2002 Fairfax has $915 of unsecured, committed bank lines, of which $620 are five-year lines (subject to reduction over the last three years of the five-year term if they are not renewed) and the remainder are non-renewed lines reducing over the period to 2004. The company has used $455 of the credit available under the lines for the issuance of letters of credit in support of its subsidiaries' reinsurance obligations, principally relating to intercompany reinsurance of subsidiaries. The only significant covenant attached to these lines is a covenant to maintain a net debt to equity ratio not exceeding 1:1.

The company manages its debt levels based on the following financial measurements and ratios (with Lindsey Morden equity accounted):

	2001	**2000**	**1999**	**1998**	**1997**
Cash and marketable securities	833.4	545.4	712.7	305.4	207.1
Long term debt	2,205.8	1,851.4	1,959.0	1,444.4	718.4
Net debt	1,372.4	1,306.0	1,246.3	1,139.0	511.3
Common shareholders' equity	3,057.6	3,180.3	3,116.0	2,238.9	1,395.7
Preferred shares and trust preferred securities of subsidiaries	560.8	592.0	578.8	–	–
OdysseyRe non-controlling interest	361.8	–	–	–	–
Total equity	3,980.2	3,772.3	3,694.8	2,238.9	1,395.7
Net debt/equity	34%	35%	34%	51%	37%
Net debt/total capital	26%	26%	25%	34%	27%
Net debt/earnings	N/A	9.5x	10.0x	3.1x	2.2x
Interest coverage	N/A	0.9x	0.7x	6.6x	8.7x

The company's financial position remains strong with net debt/equity and net debt/total capital ratios at the end of 2001 which are virtually unchanged from the end of 2000. The long term debt and net debt at December 31, 2001 includes external debt issued by OdysseyRe of $239 (US$150) in the fourth quarter of 2001. Total equity includes OdysseyRe's 26.3% non-controlling interest which supports repayment of OdysseyRe's debt. The decrease in preferred shares and trust preferred securities of subsidiaries resulted from a repurchase of trust preferred securities in the second quarter of 2001.

Fairfax has no debt maturities in 2002 and debt maturities of $184.6 in 2003. The RHINOS trust preferred securities of $217.1 also mature in 2003.

The recent net debt/earnings and interest coverage ratios reflect the company's unsatisfactory results since 1999.

Issues and Risks

The following issues and risks, among others, should also be considered in evaluating the outlook of the company.

Claims Reserves

The major risk that all property and casualty insurance and reinsurance companies face is that the provision for claims is an estimate and may be found to be deficient in the future as a result of unanticipated frequency or severity of claims or for a variety of other reasons including unpredictable jury verdicts, expansion of insurance coverage to include exposures not contemplated at the time of policy issue (e.g. asbestos, pollution, breast implants), and poor weather. Fairfax's gross provision for claims was $22,085.8 at December 31, 2001.

Reinsurance Recoverables

Most insurance and reinsurance companies reduce their liability for any individual claim by reinsuring amounts in excess of the maximum they want to retain. This third party reinsurance does not relieve the company of its primary obligation to the insured. Reinsurance recoverables can become an issue mainly due to solvency credit concerns, given the long time period over which claims are paid and the resulting recoveries are received from the reinsurers, or policy disputes. Fairfax had $12,802.1 recoverable from reinsurers as at December 31, 2001.

Catastrophe Exposure

Insurance and reinsurance companies are subject to losses from catastrophes like earthquakes, windstorms, hailstorms or terrorist attacks, which are unpredictable and can be very significant.

Prices

Prices in the insurance and reinsurance industry are cyclical and can fluctuate quite dramatically. With under-reserving, competitors can price below underlying costs for many years and still survive.

Foreign Exchange

The company has assets, liabilities, revenue and costs that are subject to currency fluctuations, particularly in the U.S. dollar but also other foreign currencies. These currency fluctuations have been and can be very significant.

Cost of Revenue

Unlike most businesses, the insurance and reinsurance business can have enormous costs that can significantly exceed the premiums received on the underlying policies. Similar to short selling in the stock market (selling shares not owned), there is no limit to the losses that can arise from most insurance policies, even though most contracts have policy limits.

Regulation

Insurance and reinsurance companies are regulated businesses which means that except as permitted by applicable regulation, Fairfax does not have access to its insurance and reinsurance subsidiaries' net income and shareholders' capital without the requisite approval of applicable insurance regulatory authorities.

Taxation

Realization of the future income taxes asset is dependent upon the generation of taxable income in those jurisdictions where the relevant tax losses and other timing differences exist.

Common Stock Holdings

The company has common stocks in its portfolio, the market value of which is exposed to fluctuations in the stock market.

Goodwill

Most of the goodwill on the balance sheet comes from Lindsey Morden. Continued profitability is essential for there to be no deterioration in the carrying value of the goodwill.

Ratings

The company has claims paying and debt ratings by the major rating agencies in North America. As financial stability is very important to its customers, the company is vulnerable to downgrades by the rating agencies.

Holding Company

Being a small holding company, Fairfax is very dependent on strong operating management, which makes it vulnerable to management turnover.

Quarterly Data *(unaudited)*
(in $ millions except per share data)

Years ended December 31	**First Quarter**	**Second quarter**	**Third quarter**	**Fourth quarter**	**Full year**
2001					
Revenue	1,528.3	1,531.7	1,336.7	1,729.0	6,125.7
Net earnings (loss)	30.9	46.0	(458.3)	35.4	(346.0)
Net earnings (loss) per share	$2.11	$3.27	$(35.23)	$1.81	$(28.04)
2000					
Revenue	1,485.6*	1,537.8*	1,345.4*	1,819.7	6,188.5
Net earnings (loss)	35.9	83.6	(22.1)	40.0	137.4
Net earnings (loss) per share	$2.58	$5.95	$(1.93)	$2.81	$9.41

* *Reclassified to conform with year-end presentation*

Stock Prices

Below are The Toronto Stock Exchange high, low and closing prices of subordinate voting shares of Fairfax for each quarter of 2001 and 2000.

	First quarter (\$)	Second quarter (\$)	Third quarter (\$)	Fourth quarter (\$)
2001				
High	289.00	234.00	242.50	227.00
Low	185.00	171.50	174.00	160.00
Close	199.50	227.90	202.31	164.00
2000				
High	246.00	194.00	201.00	242.20
Low	146.75	150.00	161.00	176.00
Close	178.00	162.00	188.25	228.50

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Supplementary Financial Information

The following unaudited financial information is prepared as supplementary information to the Company's consolidated financial statements as at and for the year ended December 31, 2001 and 2000. The purpose of each supplementary statement and its basis of preparation are discussed below.

The combined balance sheets and combined statements of earnings for Fairfax's insurance and reinsurance companies are intended to provide more detailed information on the underlying core operations. The individual balance sheets and statements of earnings of each of the underlying insurance and reinsurance companies have been added together without adjustment for items such as intersegment transactions and purchase price adjustments.

The consolidated financial statements of Fairfax with equity accounting of Lindsey Morden and TRG are intended to present Fairfax's financial position:

(a) consistent with its bank agreements where Lindsey Morden debt is excluded from the net debt to equity ratios since Lindsey Morden is a separate public company whose debt has not been guaranteed by Fairfax. Lindsey Morden is not part of Fairfax's primary operating segment of insurance and reinsurance; and

(b) excluding TRG's consolidated assets (primarily consisting of reinsurance recoverable and provision for claims) and results of operations in accordance with the economic substance of the investment. Fairfax has a minority 27.5% economic interest in TRG's net assets and results of operation and is precluded, by agreement, from exercising control over TRG's wholly-owned subsidiary, International Insurance. As discussed on page 57 of the MD&A, TRG is considered to be a financial investment and Fairfax's exposure to loss (regardless of the results of International Insurance) is limited to its US$97 investment.

The consolidated balance sheets and statements of earnings of Lindsey Morden Group Inc. are intended to provide supplementary financial information on Lindsey Morden's operations to Fairfax's consolidated financial statements with equity accounting of Lindsey Morden and TRG. These statements have been extracted from the audited consolidated financial statements of Lindsey Morden Group as at and for the years ended December 31, 2001 and 2000. For more details on Lindsey Morden, please review its annual report, which is on its website (*www.lindseymordengroupinc.com*).

The unconsolidated balance sheets of Fairfax are intended to provide a summary of the holding company's investments in its subsidiaries by operating segment and its other assets and liabilities including long term debt. The investments in subsidiaries are carried on the equity basis whereby the investment reflects the cost of acquisition and post-acquisition earnings (including the effect of purchase price adjustments) less dividends received. Certain comparative balances have been reclassified to conform with the current year's presentation.

The unconsolidated statements of earnings provide supplementary information on the holding company's sources of revenue and interest and overhead requirements, both of which are discussed in more detail under Liquidity on page 86 of the MD&A. The combined holding company statements of earnings include the unconsolidated earnings statements of Fairfax

Financial Holdings Limited, the Canadian holding company, and the U.S. holding companies which have issued long term debt or trust preferred securities and which carry out certain of Fairfax's parent company corporate functions. These statements exclude intercompany arrangements other than dividends from subsidiaries, and exclude the combined holding company's premium payments and recoveries under the corporate insurance cover with Swiss Re. None of the companies pays tax currently, and accordingly these statements are presented on a pre-tax basis.

Fairfax Insurance and Reinsurance Companies

Combined Balance Sheets

as at December 31, 2001 and 2000

(unaudited – $ millions)

	2001	2000
Assets		
Accounts receivable and other	2,221.6	2,713.3
Recoverable from reinsurers	11,949.6	7,224.3
	14,171.2	9,937.6
Portfolio investments (at carrying value)		
Cash and short term investments	1,707.7	1,437.1
Bonds	8,904.5	9,940.0
Preferred stocks	126.9	70.2
Common stocks	556.9	562.3
Real estate	16.2	64.6
	11,312.2	12,074.2
Investments in Hub and Zenith	471.3	396.5
Deferred premium acquisition costs	492.1	382.9
Future income taxes	1,344.4	989.8
Capital assets	98.2	98.8
Goodwill	33.7	31.5
Other assets	23.2	12.5
	27,946.3	23,923.8
Liabilities		
Accounts payable and accrued liabilities	937.2	1,135.2
Funds withheld payable to reinsurers	1,253.0	1,324.7
	2,190.2	2,459.9
Provision for claims	19,000.4	14,958.1
Unearned premiums	2,589.0	2,233.3
Long term debt	262.0	27.8
	21,851.4	17,219.2
Shareholders' Equity		
Capital stock	2,990.7	2,965.6
Contributed surplus	682.7	698.7
Retained earnings	231.3	580.4
	3,904.7	4,244.7
	27,946.3	23,923.8

Fairfax Insurance and Reinsurance Companies

Combined Statements of Earnings

for the years ended December 31, 2001 and 2000

(unaudited – $ millions)

	2001	2000
Revenue		
Gross premiums written	6,802.0	5,524.5
Net premiums written	5,063.0	4,335.1
Net premiums earned	4,649.9	4,297.3
Expenses		
Losses on claims	3,880.1	3,484.3
Operating expenses	750.6	674.1
Commissions, net	991.3	837.7
	5,622.0	4,996.1
Underwriting loss	(972.1)	(698.8)
Investment and other income (expense)		
Interest and dividends	491.7	593.5
Realized gains on investments	53.7	90.3
	545.4	683.8
Kingsmead losses	(116.7)	(33.0)
Restructuring and other costs	(49.1)	(16.4)
Other	(11.6)	(6.1)
	368.0	628.3
Earnings (loss) before income taxes	(604.1)	(70.5)
Provision for (recovery of) income taxes	(255.0)	(281.7)
Earnings (loss) from operations	(349.1)	211.2
Loss ratio	83.4%	81.1%
Expense ratio	37.5%	35.2%
Combined ratio	120.9%	116.3%

Fairfax with Equity Accounting of Lindsey Morden and TRG

Consolidated Balance Sheets

as at December 31, 2001 and 2000

(unaudited – $ millions)

	2001	2000
Assets		
Cash and short term investments	751.5	450.2
Marketable securities	81.9	95.2
Accounts receivable and other	3,222.0	2,724.8
Recoverable from reinsurers	10,759.3	8,900.4
	14,814.7	12,170.6
Portfolio investments		
Subsidiary cash and short term investments (market value – $2,032.6; 2000 – $1,838.0)	2,032.6	1,838.0
Bonds (market value – $10,450.4; 2000 – $10,400.7)	10,794.1	10,855.8
Preferred stocks (market value – $126.4; 2000 – $69.5)	126.8	70.2
Common stocks (market value – $941.6; 2000 – $859.8)	901.7	884.9
Real estate (market value – $82.7; 2000 – $76.3)	78.3	76.3
Total (market value – $13,633.7; 2000 – $13,244.3)	13,933.5	13,725.2
Investment in Lindsey Morden and TRG	308.0	305.9
Investments in Hub and Zenith National	471.3	396.5
Deferred premium acquisition costs	518.0	386.7
Future income taxes	1,699.6	1,263.6
Premises and equipment	175.3	87.7
Goodwill	43.8	34.1
Other assets	85.2	61.6
	32,049.4	28,431.9
Liabilities		
Accounts payable and accrued liabilities	1,743.2	1,320.2
Funds withheld payable to reinsurers	1,793.1	1,325.3
	3,536.3	2,645.5
Provision for claims	19,665.0	17,831.9
Unearned premiums	2,645.9	2,252.3
Long term debt	2,205.8	1,851.4
Trust preferred securities of subsidiaries	360.8	392.0
	24,877.5	22,327.6
Non-controlling interest	361.8	–
Excess of net assets acquired over purchase price paid	16.2	78.5
Shareholders' Equity		
Common stock	2,261.4	2,012.9
Preferred stock	200.0	200.0
Retained earnings	796.2	1,167.4
	3,257.6	3,380.3
	32,049.4	28,431.9

Fairfax with Equity Accounting of Lindsey Morden and TRG

Consolidated Statements of Earnings

for the years ended December 31, 2001 and 2000
(unaudited – $ millions except per share amounts)

	2001	2000
Revenue		
Gross premiums written	6,838.0	6,054.3
Net premiums written	5,045.1	4,566.5
Net premiums earned	4,806.7	4,610.7
Interest and dividends	602.5	742.8
Realized gains on investments	173.6	381.6
Realized gain on OdysseyRe IPO	51.2	–
Equity earnings (loss) of Lindsey Morden and TRG	10.0	(7.7)
	5,644.0	5,727.4
Expenses		
Losses on claims	4,061.2	3,755.5
Operating expenses	882.9	840.0
Commissions, net	1,041.4	885.2
Interest expense	160.1	164.7
Restructuring and other costs	49.1	16.4
Swiss Re premiums	143.6	167.2
Kingsmead losses	116.7	33.0
Negative goodwill	(59.7)	(99.2)
	6,395.3	5,762.8
Earnings (loss) before income taxes	(751.3)	(35.4)
Provision for (recovery of) income taxes	(382.1)	(172.8)
Net earnings (loss) before non-controlling interests	(369.2)	137.4
Non-controlling interests	(23.2)	–
Net earnings (loss)	(346.0)	137.4
Net earnings (loss) per share	$ (28.04)	$ 9.41

Lindsey Morden Group Inc.

Consolidated Balance Sheets

as at December 31, 2001 and 2000

($ millions)

	2001	2000 [Restated]
Assets		
Cash	2.8	1.4
Accounts receivable	98.4	87.9
Claims in process	51.5	52.1
Prepaid expenses	6.4	5.5
Income taxes recoverable	1.6	7.0
	160.7	153.9
Property and equipment	29.3	29.8
Goodwill	230.7	225.6
Future income taxes	13.9	14.7
Other assets	24.2	25.0
	458.8	449.0
Liabilities		
Bank indebtedness	43.0	42.5
Accounts payable and accrued liabilities	89.2	76.7
Income taxes payable	1.6	8.5
Current portion of long term debt	10.6	2.3
Deferred revenue	28.0	28.0
Future income taxes	5.3	6.6
	177.7	164.6
Long term debt	127.7	133.5
Employee future benefits	5.5	5.7
Other liabilities	3.4	3.1
	314.3	306.9
Shareholders' Equity	144.5	142.1
	458.8	449.0

Lindsey Morden Group Inc.

Consolidated Statements of Earnings

for the years ended December 31, 2001 and 2000

($ millions except per share amounts)

	2001	2000 *[Restated]*
Revenue	438.9	377.3
Cost and expenses		
Cost of service	350.5	306.0
Selling, general and administration	75.7	69.7
Interest	13.5	14.9
Other	–	13.8
	439.7	404.4
Earnings (loss) before income taxes	(0.8)	(27.1)
Recovery of income taxes	(4.1)	(13.0)
Earnings (loss) before goodwill amortization	3.3	(14.1)
Goodwill amortization	9.1	9.0
Net earnings (loss)	(5.8)	(23.1)
Earnings (loss) per share		
Including goodwill amortization	$ (0.41)	$ (1.94)
Excluding goodwill amortization	$ 0.23	$ (1.18)

Consolidated Statements of Retained Earnings (Deficit)

for the years ended December 31, 2001 and 2000

($ millions)

	2001	2000 *[Restated]*
Retained earnings (deficit) – beginning of year	(15.0)	20.6
Net earnings (loss) for the year	(5.8)	(23.1)
Dividends paid	–	(12.5)
Retained earnings (deficit) – end of year	(20.8)	(15.0)

Fairfax Financial Holdings Limited

Unconsolidated Balance Sheets

as at December 31, 2001 and 2000
(unaudited – $ millions)

	2001	2000 *[Restated]*
Assets		
Subsidiary companies		
Insurance – Canada	593.0	565.2
Insurance – US	1,981.1	1,789.8
Reinsurance	1,017.0	1,567.8
Runoff	440.0	301.3
Other investments	19.5	20.7
	4,050.6	4,244.8
Cash and short term investments	751.5	450.2
Marketable securities	81.9	95.2
Swiss Re recoverable (net)	543.4	311.8
Other assets	86.5	128.1
	5,513.9	5,230.1
Liabilities		
Accounts payable and other liabilities	382.6	82.6
Long term debt	1,873.7	1,767.2
	2,256.3	1,849.8
Shareholders' Equity		
Common stock	2,261.4	2,012.9
Preferred stock	200.0	200.0
Retained earnings	796.2	1,167.4
	3,257.6	3,380.3
	5,513.9	5,230.1

Fairfax Financial Holdings Limited

Unconsolidated Statements of Earnings

(combined holding company earnings statements)

for the years ended December 31, 2001 and 2000

(unaudited – $ millions)

	2001	2000
Revenue		
Dividend income	54.9	322.8
Interest income	8.8	21.1
Management fees	24.5	24.3
Realized gains (losses)	84.2	23.8
Realized gain on Odyssey IPO	51.2	–
	223.6	392.0
Expenses		
Interest expense	166.0	165.3
Operating expenses	51.4	51.0
Other	6.7	22.7
	224.1	239.0
Earnings (loss) before income taxes	(0.5)	153.0

APPENDIX A – NOVEMBER 3, 2001 LETTER TO SHAREHOLDERS

FAIRFAX
FINANCIAL HOLDINGS LIMITED

November 3, 2001

To our shareholders:

It is now exactly two years from the day I wrote to you in 1999 after our stock price dropped dramatically when the 1999 second quarter results were reported. Fairfax was trading at $210 then and it is trading at $207 today. In spite of a tremendous improvement in our two large U.S. insurance companies, our results have not been good during this time period and our stock price reflects this.

Recently, we have had two negative surprises that are reflected in our third quarter loss — the largest loss we have had since we began in 1985.

1. World Trade Centre losses

   The tragic events of September 11 resulted in a gross loss of US$625 million ($964 million) and a net, after reinsurance, pretax loss of US$152 million ($234 million). Excluding the minority interest of 26% of OdysseyRe that is public, Fairfax had a net pretax loss of US$131 million ($202 million), not too different from the range which we announced on September 17, 2001. We have solid reinsurers backing our recoveries with more than 90% rated A– and above.

2. Reserve deficiencies

   During the first nine months of 2001, we had significant development in the prior years' reserves of Crum & Forster (CFI) and TIG. For CFI, we booked a gross reserve increase of US$400 million, which includes the US$190 million remaining protection on 1998 and prior reserves which we obtained on the acquisition of CFI and US$210 million gross for the 1999 and 2000 accident years. After reinsurance, the net cost to CFI of this reserve increase was US$74 million ($115 million). For TIG, we booked a gross reserve increase of US$200 million, primarily for the 1999 and 2000 accident years which, after reinsurance, cost TIG US$113 million ($174 million).

   While this was a surprise for us, and clearly very embarrassing, given our policy of always being well reserved, you should note that:

   (a) This is an industry phenomenon as company after company in the U.S. has recently reported similar developments reflecting the soft insurance markets of the late 1990s.

   (b) Our management teams, led by Bruce Esselborn at CFI and Courtney Smith at TIG, have been running our companies for only two years. Against the backdrop of the worst insurance market in thirty years, it has taken longer for them to fix the problems of the past.

   (c) These reserve increases, large as they have been, clearly put the past behind us and position both companies firmly for the future.

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So, with hindsight, would we have bought these companies? You be the judge. The table below shows purchase price vs book value for both companies.

Purchase Price vs Book Value
(US$ millions)

	Purchase Price	Book at Purchase	Book at Sept 30/01
CFI	680	857[1]	957
TIG	845	804[2]	852

[1] After pre-acquisition reserve strengthening of $227
[2] After pre-acquisition reserve strengthening and other balance sheet cleanup of $211

In spite of the reserve strengthening, CFI's purchase price is well below its book value at September 30, 2001 and TIG's is about the same. And, now we have a major presence in commercial insurance in the world's largest insurance market just as these markets are tightening significantly. Please remember also that with TIG, we acquired TIG Re, which helped make OdysseyRe one of the largest broker reinsurers in the world.

These companies could not be purchased today at the prices we paid for them and, unlike other companies in our industry, we have no goodwill to speak of on our balance sheet.

Combined Ratios for CFI/TIG

Because of the significant transition that both companies have undergone in the past two years, we think it is important to focus on the policy year combined ratio, that is the combined ratio of the business written, new and renewed, in 2001. For CFI, this is running at 104% and for TIG at 108%. Given the very significant price increases being achieved currently, our 100% target combined ratios for 2002 are in sight.

Investment Portfolios

While the right hand side of our balance sheet has disappointed us in 2001, the left hand side has been very strong. Primarily because of our S&P put position (US$1.1 billion at an average exercise price of 1206), we had an unrealized gain in our investment portfolio in excess of $300 million at September 30, 2001. As of October 31, the drop in long U.S. treasury interest rates has resulted in our bond portfolios having an unrealized gain of approximately $250 million (a far cry from an unrealized loss of $463 million as of December 31, 2000 and $1,241 million as of December 31, 1999). We think the U.S. is in a recession and the only question is how long and how deep. With 93% of the portfolio in high quality bonds (and an option feature that extends the average maturity to 18 years) and US$1.1 billion in S&P puts, we think we are very well positioned for this environment. As discussed in the 2000 Annual Report, if U.S. long treasuries drop to 4%, the unrealized gain in our bond portfolios would be about $800 million.

Property and Casualty Industry Conditions

When we began in September 1985, industry conditions in Canada and the U.S. were just turning. Our largest competitor went bankrupt in late 1985 and our premiums quadrupled in 1986 as the pricing environment turned dramatically. In the P&C industry, this is called a hard market. Beginning in 1988, pricing began to soften again and only began turning upwards in 2000. In our 2000 Annual Report, we listed some of the reasons why we felt the cycle had turned. With the World Trade Centre industry loss, estimated to be in the US$30 to US$50 billion range, we are in a hard market again — the best since we began in 1985.

Insurance capacity is being severely limited, prices are going up dramatically and policy terms and conditions have tightened significantly.

For the past 15 years, we have carefully expanded through acquisition, as the opportunity to grow internally was very limited. This has now changed. We expect to grow each of our insurance/reinsurance businesses significantly during this hard market. In the last hard market, we had one company, Markel Insurance. In the current one, we have four Canadian companies, three U.S. companies and one large worldwide reinsurer — all with excellent management and operating on a decentralized basis unburdened with bureaucracy — to grow their businesses significantly in this market.

Given the opportunity that we see in the P&C industry and given the two negative surprises that we have had in 2001, we have decided to do an issue of subordinate voting shares to strengthen our balance sheet and to take full advantage of the growth opportunities ahead of us. While this issue is very mildly dilutive to you, we think that, longer term, the internal growth opportunities will more than compensate. Note, we are not doing this issue to buy another company, something I said we would not do below $500 per share. This equity issue will help increase cash in the holding company to a level in excess of $800 million at year end 2001! In addition, we continue to have over $1 billion in bank lines.

While we have one of the best long-term track records in our industry, we have not performed for you, our shareholders, in the past three years. We believe our time has come and that your patience will be rewarded.

V. P. Watsa

V. Prem Watsa

APPENDIX B

GUIDING PRINCIPLES FOR FAIRFAX FINANCIAL HOLDINGS LIMITED

OBJECTIVES:

1) We expect to earn long term returns on shareholders' equity in excess of 20% annually by running Fairfax and its subsidiaries for the long term benefit of customers, employees and shareholders – at the expense of short term profits if necessary.

   Our focus is long term growth in book value per share and not quarterly earnings. We plan to grow through internal means as well as through friendly acquisitions.

2) We always want to be soundly financed.

3) We provide complete disclosure annually to our shareholders.

STRUCTURE:

1) Our companies are decentralized and run by the presidents except for performance evaluation, succession planning, acquisitions and financing which are done by or with Fairfax. Cooperation among companies is encouraged to the benefit of Fairfax in total.

2) Complete and open communication between Fairfax and subsidiaries is an essential requirement at Fairfax.

3) Share ownership and large incentives are encouraged across the Group.

4) Fairfax will always be a very small holding company and not an operating company.

VALUES:

1) Honesty and integrity are essential in all our relationships and will never be compromised.

2) We are results oriented – not political.

3) We are team players – no "egos". A confrontational style is not appropriate. We value loyalty – to Fairfax and our colleagues.

4) We are hard working but not at the expense of our families.

5) We always look at opportunities but emphasize downside protection and look for ways to minimize loss of capital.

6) We are entrepreneurial. We encourage calculated risk taking. It is all right to fail but we should learn from our mistakes.

7) We will never bet the company on any project or acquisition.

8) We believe in having fun – at work!

Consolidated Financial Summary *(in $ millions except share and per share data)*[1]

		Per Share										
	Return on average shareholders' equity	Shareholders' equity	Net earnings – fully diluted	Revenue	Earnings before income taxes	Net earnings	Total assets[2]	Investments	Net debt[3]	Shareholders' equity	Shares outstanding	Closing share price
As at and for the years ended December 31:												
1985	–	2.08	(1.89)	17.0	(0.9)	(0.9)	41.5	32.7	–	10.4	5,000	3.25[4]
1986	25.4%	5.89	1.35	53.7	9.1	6.5	129.8	95.6	2.8	41.3	7,007	12.75
1987	31.3%	8.32	2.23	113.0	18.2	16.0	185.4	124.0	2.8	61.0	7,337	12.37
1988	21.2%	10.13	1.94	133.6	21.3	14.4	246.8	137.5	28.2	74.2	7,322	15.00
1989	20.3%	12.41	2.25	125.8	19.2	16.7	248.1	133.9	22.0	90.8	7,316	18.75
1990	23.0%	17.29	2.92	195.4	23.2	21.3	536.0	335.7	65.9	94.7	5,477	11.00
1991	21.3%	21.41	3.94	250.0	32.5	22.5	516.6	341.2	51.3	116.8	5,455	21.25
1992	7.7%	23.76	1.76	286.8	7.0	10.0	590.5	396.2	68.2	143.8	6,055	25.00
1993	20.3%	35.13	5.42	344.0	46.7	33.3	1,200.3	848.8	132.4	279.5	7,955	61.25
1994	12.1%	43.77	4.66	634.9	46.0	38.1	2,173.4	1,551.3	218.0	391.9	8,955	67.00
1995	20.1%	53.28	9.79	1,145.5	95.9	87.5	2,873.5	1,668.1	227.7	472.6	8,869	98.00
1996	21.4%	87.05	15.36	1,475.8	187.3	150.8	5,778.4	3,454.5	369.4	911.1	10,466	290.00
1997	20.4%	125.38	21.59	2,088.3	336.0	232.5	10,207.3	5,795.7	511.3	1,395.7	11,132	320.00
1998	20.1%	184.54	32.63	3,574.3	484.8	387.5	20,886.7	12,108.4	1,139.0	2,238.9	12,132	540.00
1999	4.3%	231.98	9.20	5,788.5	(17.3)	124.2	31,979.1	17,434.9	1,246.3	3,116.0	13,426	245.50
2000	4.1%	242.75	9.41	6,188.5	(32.9)	137.4	31,833.3	15,290.7	1,306.0	3,180.3	13,101	228.50
2001	(11.9%)	213.06	(28.04)	6,125.7	(736.1)	(346.0)	35,438.7	15,947.9	1,372.4	3,057.6	14,351	164.00

(1) All share references are to common shares

(2) Commencing in 1995, reflects a change in accounting policy for reinsurance recoverables

(3) Total debt (beginning in 1994, net of cash in the holding company) with Lindsey Morden equity accounted

(4) When current management took over in September 1985

Directors of the Company

* Winslow W. Bennett
President, Winwood Holdings Ltd.

* Anthony F. Griffiths *(as of April 2002)*
Corporate Director

* Robbert Hartog
President, Robhar Investments Ltd.

Paul B. Ingrey
Chairman and Chief Executive Officer, Arch Reinsurance Ltd.

V. Prem Watsa
Chairman and Chief Executive Officer

* *Audit Committee Member*

Operating Management

John Watson, Chairman
Ronald Schwab, President
Commonwealth Insurance Company

Bruce Esselborn, Chairman
Crum & Forster Holdings, Inc.

Kenneth Kwok, President
Falcon Insurance Company Limited

John M. Paisley, President
Federated Insurance Company of Canada

Anthony F. Hamblin, President
Hamblin Watsa Investment Counsel Ltd.

Martin P. Hughes, Chairman
Richard A. Gulliver, President
Hub International Limited

Karen Murphy, President
Lindsey Morden Group Inc.

Byron G. Messier, President
Lombard General Insurance Company of Canada

Mark J. Ram, President
Markel Insurance Company of Canada

Andrew A. Barnard, President
Odyssey Re Holdings Corp.

Philip Broughton, President
Ranger Insurance Company

James F. Dowd, Interim President
TIG Specialty Insurance Company

Michael A. Coutu, Chairman
Dennis C. Gibbs, President
TRG Holding Corporation

Officers of the Company

Trevor J. Ambridge
Vice President and Chief Financial Officer

Sam Chan
Vice President

Francis Chou
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Vice President and Chief Actuary

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Vice President

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Vice President and Corporate Secretary

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Vice President, Corporate Affairs

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Vice President, Finance

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Chairman and Chief Executive Officer

M. Jane Williamson
Vice President

Officers of Fairfax Inc.

Cindy Crandall, Vice President
James F. Dowd, President
Scott Galiardo, Vice President
Roland Jackson, Vice President

Head Office

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Auditors

PricewaterhouseCoopers LLP

General Counsel

Torys

Transfer Agent and Registrar

CIBC Mellon Trust Company

Share Listing

The Toronto Stock Exchange
Stock Symbol FFH

Annual Meeting

The annual meeting of shareholders of Fairfax Financial Holdings Limited will be held on Tuesday, April 16, 2002 at 9:30 a.m. in Room 106 at the Metro Toronto Convention Centre, 255 Front Street West, Toronto.

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